No. 5874

IN THE

United States Circuit Court of Appeals

IN AND FOR THE NINTH JUDICIAL CIRCUIT
IN EQUITY

CHARLES A. BURCKHARDT,
vs.
NORTHWESTERN NATIONAL BANK, et. al.,
Respondents.

FRED A. BALLIN,
Appellant,
vs.
THE NORTHWESTERN NATIONAL BANK, et. el.,
Respondents.

Brief of Appellants

MESSRS. SHEPPARD, PHILLIPS & RALSTON, MESSRS. CAREY & KERR, MR. C. A. HART, MR. JOHN F. LOGAN, MESSRS. WINTER & MAGUIRE, MESSRS. DEY, HAMPSON & NELSON, MR. M. A. ZOLLINGER, All of Portland, Oregon,

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LANE-MILES STANDISH CO.

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ABSTRACT OF STATEMENT OF THE CASE

(Rule 24 (a))

Because of the acts, conduct and things the respondents did do, and failed, neglected or refused to do, in consequence of which in the affairs and transactions intrusted to them, the institution hereinafter mentioned was put out of business, Burckhardt and Ballin were respectively complainants in the District Court in and for the District of Oregon, by their respective bills of complaint upon the part of all stockholders in equity to invoke the trust relationship that exists between the corporation and directors on the one part, and the stockholders upon the other in what is alleged and proved to be the mismanagement of the Northwestern National Bank, a national banking association and a member of the Federal Reserve in Portland, Oregon, by the impairment of its capital and surplus and its asset values and to obtain an accounting therefor and for the value of the shares of the respective complainants' stock against notes then claimed to be held by and since paid to and received by the bank.

The duties, arising from the fiduciary obligation asserted in the respective bills of complaint, were not alone based upon the particular means by which or the manner in which the particular things established by the evidence were done or exercised or carried on, but on the fact of the policy of con-

trol, direction and management which the respondents held of the common bank property and in the way they exercised their functions to the destruction of the bank.

The complainants as a basis for the theory upon which they brought these suits asserted it to be a firmly established principle of equity that where one person occupies a relation or position where he owes a duty to another, he shall not place himself in any way to act contrary to that duty, and if he does so act *a court of equity will not inquire whether he had in fact violated his duty but will grant relief irrespective of good or bad faith or intention if the other party to the relationship or position desires it; and these cases are predicated upon this equitable principle.*

The theory was constantly presented to the trial court that the banking corporation itself was a trustee for stockholders, that its directors themselves were trustees for the stockholders and that the minority rights could not be prejudiced by the action of the majority in the way they piled up losses as directors of said bank resulting in its destruction as a going concern.

It is believed and was at the trial asserted and is here again asserted that the trial court failed to recognize this theory of the complainants and staunchly adhered to a theory entirely different,

apparently requiring that the complainants should show some dishonesty or criminal purpose in terms of the Banking Act *quite aside from the common law liability of the director or his trust relation to the stockholder;* and the trial court seemed to disregard the entire theory made by the bills of complaint and as presented by the evidence, to-wit: that the directors of a bank, as the evidence showed, replete with assets and of high standing resources running somewhere in the neighborhood of twenty-eight millions, in a short period of time should find itself entirely defunct and a creature for disposition by a majority of the stock of the bank without the consent of all of the stockholders at the time the directors so did and certainly without the consent of these complainants, and also stockholders Cotton and Griffith.

It was also submitted that the minority stockholders were made subject to not only the liability by the Banking Act but to contingent liability created by the acts of these directors and by the mismanagement of the bank's affairs in such way and manner as to entirely ruin the value of their stock and subject them to liabilities without their consent because the creation of these liabilities in such manner did not have the warrant of law.

The court below persistently held that it was not enough to show mismanagement, inattention, or negligence, but that violations with dishonest

purpose must have knowingly been committed, or that directors knowingly permitted someone to violate the law, and that in the absence of any such proof no equitable relief could be had. The trial court seemed to be of the opinion that the theory of complainants was to make the directors guarantors of the fidelity of the employees and that in failing to prove, if there was such failure, which is not conceded, any violation of the criminal side of the Banking Act, there was nothing upon which to base, by equitable doctrine, a liability upon any director to account to the bank or to the complainants or either of them. Hence, this appeal.

It will aid the court to a consideration of the matters involved to have a

SUMMARY OF THE IMPORTANT EVIDENCE

In order to do this direct quotations shall have to be made from the statement of the evidence prepared upon this appeal as the printed record is not yet at hand for reference and cannot be furnished in time within which the rule requires this brief to be prepared.

In March, 1923, L. B. Menefee, then a Director and one of the Examining Committee, together with Jones and Standifer, stockholders, sold some 4,200 shares for $150.00 a share to J. E. Wheeler, and the record discloses that Olmstead, himself, aided Wheeler in securing the necessary financing

for the purchase of this stock to block the sale of the bank which had theretofore been arranged by O. L. Price and the other defendants in this case; in March, 1923.

The record also shows that in 1923 before Sensenich left the bank in June, change in management by eliminating Olmstead was suggested and continued to be a growing suggestion ultimately voiced by the Comptroller, and that the first discussion of a change in management was in the fall of 1922. These things were discussed by Charlton, Metschan, Spalding and Price, and Price discussed it in June, 1926 with the Comptroller, Washington.

The Court discharged Chauncey McCormick, one of the directors, upon the ground that the suits brought *were not of a local nature*, and that as he was a resident of Illinois he could not be sued in the District of Oregon.

O. L. Price became a director April 6, 1914; Nat McDougall, January 11, 1916; Chas. K. Spalding, July 29, 1918; C. A. Morden, January 6, 1919; Mark Skinner, January 9, 1922; Chas. H. Stewart, July 1, 1922; James F. Twohy, August 28, 1922; Frederick F. Pittock, December 1, 1922; E. S. Collins, July 19, 1923. Emery Olmstead and A. D. Charlton were directors from the time the bank was organized in 1912, and Phil Metschan became a director January 13, 1920.

Exhibits 21 to 26, inclusive, exemplified the oaths of office, certified by the Comptroller, of these directors for 1922 to 1927, both inclusive.

O. L. Price became president in stead of Emery Olmstead on March 1st, 1927.

On March 29th, 1927, the institution ceased to conduct its business.

Of the directors above named Olmstead, Price, Charlton, Metschan, Spalding, Pittock and Skinner were substantially the controlling members of the executive committee from 1923 on, meeting every Tuesday. On occasion some one other director or officer acted, like Stewart.

By-laws of this banking association specifically provided that the Board of Directors *and not the President* managed, directed and controlled the conduct of the association.

Under By-laws 6 and 7, Chairman of the Board, O. L. Price, *was the President's superior officer.*

Under By-law 13 the Executive Committee and seven members chosen from and appointed by the Directors as specified were specifically assigned.

> "It shall be the duty of the Executive Committee to keep fully informed in regard to current business of the association and, when the Board is not in session, to superintend the

transaction thereof; to pass upon, supervise, regulate and control lines of credit, investments of funds of the bank, purchases and sales of securities, loans on collateral, discounts, and purchases of bills, notes and other evidences of debt, and purchases and sales of bills of exchange; to fix all salaries and compensations paid or payable by the association, except as otherwise declared in the by-laws or by resolution of the Board of Directors; to fill any vacancy in the Committee by election of a member of the Board of Directors, to be confirmed by the Board at its next meeting, and, in the event of the absence of any member of the Executive Committee, in its discretion to appoint a member of the Board of Directors to fill the place of such absent member, to serve during such absence. The Committee shall meet at least once each week, and a majority of the members of the Committee shall constitute a quorum thereof necessary for the transaction of business. The Committee shall appoint a secretary whose duty it shall be to record the proceedings of the Committee in full in a minute book of the bank, to be kept and provided for such purpose, and the record of such proceedings shall be signed by all members of the Committee participating therein. Such record shall be open at all times to the inspection of any member of the Board of Directors, and all action by the Executive Committee shall be reported to the Board of Directors at its meeting next succeeding such action." (r. pp. 33-34)

These directors were paid under and pursuant to By-law 19 of the bank $10.00 for attendance at regular or special meetings of the Board and $20.00

for attendance at regular or special meetings of the Executive Committee. Under Section 19 of the By-laws as amended, and in force during the times set forth in the bills of complaint, in addition to these compensations Messrs. Charlton and Metschan commencing in the year 1921 were paid separately as members of the Examining Committee, and in addition to their compensation as Directors, $375.00 each, and in the year 1922 $375.00 each, and in the year 1923 $400.00 each, and this was the compensation each year received by Chas. K. Spalding who with Metschan and Charlton became a member of the Examining Committee. These members of the Examining Committee in addition to their pay as Directors in 1924 received $400.00 each, and in 1925 $400.00 each, and in 1926 $600.00 each, etc. And these compensations continued down to and inclusive of the time that the bank closed, and were specially paid for the services referred to in the by-laws. Olmstead, Skinner and Stewart as Directors were officers of the bank and paid regular salaries, amounting to several thousand dollars each per annum. *Not one of the directors involved in these proceedings was a gratuitary bailee or agent; but a paid employee.*

Ballin first became a stockholder July 1, 1918, and paid for 100 shares of stock $125.00 a share. Afterwards and in July, 1922, when the capital stock was increased Ballin paid for an additional 100 shares, $150.00 a share.

Burckhardt paid for his stock June 25, 1918, 250 shares at $125.00 a share.

Exhibits 53, 56, 56(a) and 57, and Exhibits 58 and 59, make clear the reflection of the increase of stock to the transactions of Burckhardt.

Substantially, the standard form which the Examining Committee of this bank used and employed during the whole period of time involved in this proceeding, after stating the dates that the examination may have covered, read as follows:

> "We counted the cash; examined bonds and other securities; we very carefully checked the notes, collateral and real estate. We checked the outstanding and certified checks, cashier's checks, time and demand certificates of deposit and overdrafts; we verified the outstanding stock certificates; verified the first clearings; examined the expense account and general affairs of the bank, making a full and complete examination of same.
>
> "We found the books correct; that the bank is in good condition and that the value at which the assets are carried on the books is fully justified.
>
> Respectfully yours,
> (Signed) Geo. H. Kelly,
> A. D. Charlton,
> C. A. Morden."

except that when the Examining Committee changed, the names signed were different. Latterly, Charlton, Metschan and Spalding.

In July, 1922, the bank increased its capital stock from $1,000,000.00 to $2,000,000.00 and its surplus from $250,000.00 to $400,000.00, and on March 6, 1922 the directors resolved that the increased capital stock of the bank be offered for sale at $150.00 per share, and that the stockholders be given until April 1, 1922 within which to take their proportion, to be paid for in cash on or before June 15, 1922.

It is proper to call attention to the fact that after this increase in capital stock the evidence shows that the Examining Committee on November 21, 1922, called to the attention of the Board of Directors, using the form as above set forth, specific items aggregating many lines in which among other things they recommended reduction and also of expenses of the bank to extent of $40,000.00 per year.

On the 16th day of January, 1923, Price, Olmstead, Charlton, Pittock, Menefee, Skinner and others being present, a letter signed by the Directors present was addressed to the Comptroller of the Currency at Washington, D. C., in which among other things it was stated by these Directors:

> "At a meeting of the board of directors of the Northwestern National Bank of Portland, held on this date with Examiner M. C. Wilde, the general condition of the bank and the

following matters of criticism were fully considered—slow and doubtful assets aggregating $4,426,666.04 and $539,418.44, respectively, and estimated losses, $143,894.36.

Directors are cooperating with the officers, and a united effort is being made to eliminate matters of criticism and improve the general condition of the bank." (r. 48-49)

Following this on the 21st day of June, Directors Metschan, Charlton, Pittock, Stewart, Spalding, Skinner, Price and Olmstead addressed the Comptroller of the Currency a letter, among other things, as follows:

At a meeting held June 21st with Examiner M. C. Wilde careful consideration was given by the undersigned directors of the Northwestern National Bank of Portland, Oregon, to all matters of criticism contained in the Examiner's report of examination of this bank, now under examination.

"Losses aggregating $102,947.77 were charged off during the examination.

"Slow assets aggregating $3,757,066.77, doubtful assets $426,756.25, statutory bad debts $1,020,068.72, other overdue paper $711,396.01 and the Merchants National Bank, liquidating account, totaling $184,699.34 listed undesirable in the report were considered in detail. These matters are having careful attention of officers and directors and efforts will be continued to improve this condition and reduce these amounts.

"Large lines and other loans especially mentioned by the Examiner were called to our attention.

"It is hoped to fill the three existing vacancies in the board of directors within thirty to sixty days."

The Examining Committee of the bank had reported to the Directors their knowledge of these affairs, and on July 28, 1924, the Treasury Department at Washington through Deputy Comptroller, Mr. McIntosh, wrote the Board of Directors of the Northwestern National Bank among other things, as follows:

The report of an examination of your bank, completed July 11, a copy of which should be in your possession, has been received, and shows *a condition not satisfactory to this office.*

Reports of examination of your association since April, 1921, have been carefully reviewed and show that during the intervening time your bank has been subject to continuous criticism because of a constant accumulation of slow and doubtful assets. The following figures will substantiate this statement:

Report of Examination	Slow	Doubtful
April, 1921	$4,932,220	$446,030
Dec., 1921 and Jan., 1922	4,879,618	457,638
June, 1922	3,188,187	474,706
Dec., 1922 and Jan., 1923	4,426,666	539,418
May and June, 1923	4,050,114	618,396
Dec., 1923 and Jan., 1924	4,325,182	596,020
June, 1924 and July, 1924	4,346,073	528,410

This office desires, however, to urge the management to even greater efforts and to impress upon the directors and officers the fact that energetic efforts and vigorous methods sel-

dom fail to accomplish a great deal... It is hoped by the time of the next examination that the collectibility of paper now held will be definitely demonstrated and that its character will have been improved to an extent which will result in a minimum of loss to the bank.

Particular attention is directed to the following lines and it is urged that they be substantially reduced by the time of the next examination:

Dufur Farm and Fruit Co. ..... (All listed as slow, large loss probable unless orchard is disposed of. Deal now pending for disposition.)	$524,746
Bankers Discount Corporation ..... (Shows an increase since last examination and is all listed slow or doubtful. Loss probable.)	770,112
Pacific Grain Co. ..... (All listed slow and loss probable)	441,122
C. S. Hudson, et. al ..... (Large part listed as slow, some doubtful in bad debts.)	244,543
Northwest Fruit Products Company and Phez Company ..... (All listed slow and doubtful.)	192,000
J. E. Wheeler, Interests ..... (All listed slow in current and overdue paper.)	584,500

Note: *These items alleged in the complaints.*

These things were before considered especially by Olmstead, Pittock, Metschan, Pittock and Skinner, in a meeting of August 20, 1924, and September 8th, 1924; but still remained undone.

With a continuance of the situation the Board of Directors on the 23rd of October, 1925, consisting of respondents Stewart, McDougall, Charlton, Metschan, Spalding, Olmstead, Price and Skinner, wrote the Comptroller of the Currency at Washington as follows:

> The undersigned directors of the Northwestern National Bank met October 23, 1925, with Chief National Bank Examiner, Mr. T. E. Harris, and National Bank Examiner, Mr. M. C. Wilde, at which meeting there was discussed and called to our attention the various matters of criticism, and the unfavorably classified assets shown in the recapitulation of the Examiner's report completed as of this date.
>
> The undersigned directors have assured your Examiners that from their own and personal knowledge, or from reports and information furnished them, that are believed responsible and reliable, the value of assets acquired from the Merchants National Bank, now carried on the bank's books at $498,948.04, is in excess of the carrying figures, and of sufficient value to protect the bank against further loss in this account, notwithstanding the statement contained in President Olmstead's letter dated August 1st, 1923, addressed to your Examiner, giving a much lower valuation at that time, and noting the Examiner's statement to the directors that he does not share the Directors' optimistic view concerning the valuation placed on these assets.
>
> In accordance with our agreement with your Examiners, we will continue to apply our profits as earned to retire the balance of the

paper listed as losses in the Examiner's report. Furthermore we have exercised an option for the sale of our banking house, which, if exercised, will yield a profit of over $200,000. When this profit is realized, it will be applied on the Examiner's estimated doubtful paper.

Serious consideration will be given to the suggestion and recommendation of your Examiners that a "corporation be organized among the shareholders of the bank for the purpose of purchasing as much as possible of the non-income producing assets.

Assurance is given that the management and directors of this bank will continue their earnest endeavors to place this bank in a more satisfactory condition, and serious consideration will be given to all suggestions offered by your Examiners, for the welfare and benefit of the bank.

Respectfully
(Signed)
Chas. H. Stewart
Natt McDougall
A. D. Charlton
Phil Metschan
Chas. K. Spalding.
F. F. Pittock
Emery Olmstead
O. L. Price
M. Skinner.
(R. 140-41)

To this on November 17, 1925, the Comptroller of the Currency wrote the Board of Directors among other things, as follows:

It is thought that the condition of the institution is more serious than the directors will

permit themselves to believe. You are requested therefore, to give the matter very thorough consideration and to endeavor to arrange some plan by which the more dangerous assets may be eliminated. If you are unable to do that, such credit information should be obtained as will enable a more accurate appraisal of the assets than examiners apparently have been able to make in the past.

If such an appraisal should disclose that losses existed in sufficient amount to impair capital, an assessment of the stock could be issued by this office for the purpose of correcting the situation.

This was followed by a letter of the 26th of April, 1926, to the Directors from the Comptroller of the Currency:

The report of an examination of your bank, completed by National Bank Examiner M. C. Wilde, on April 6, 1926, has been received and while indicating improvement along some lines, it does not evidence the degree of improvement that was hoped for and which it is thought might have shown had the management proceeded with collections with the energy which a situation such as yours requires.

Assets classed as slow in the current report amount to $3,734,572.44, including the Merchants Liquidating Account of $498,888.65; while doubtful assets of $513,130.02 are reported, exceeding surplus, undivided profits and reserve accounts, when items of $31,661.79 classed as losses, are taken into consideration.

An exhaustive review of past reports at the time of the previous examination forced the

conclusion that the condition of your bank is more serious than the directors and management believe and the current report bears out that conclusion. Unless, therefore, there is a decided change for the better by the time of the next examination in the character of assets classed as slow and doubtful in the last report, it will be necessary to place thereon much lower valuations than have been given in former reports and this, of course, will necessitate a heavy estimate of losses.

It may be that what is needed in your bank, if its affairs are to be rehabilitated to the satisfaction of the examiner and this office, is an entire change in management. It would seem that capable management should have, over a period of years succeeded in relieving the bank's unsatisfactory condition, but your bank has been continuously unsatisfactory since 1920, which indicates conclusively that there is something wrong in the plan of operation. If a change in management is not feasible at this time, the present management should at least be strengthened by some person of energy and ability, who can and will vigorously proceed to realize all that is possible out of the many slow and doubtful loans and other assets that have been in the bank for so many years. Please give this matter your very earnest consideration.

"The examiner reports that deeds and assignments are now being prepared, by which your bank will acquire title to all of the assets taken from the Merchants National Bank in 1915, a large part of which is real estate. It is proposed, then, to organize a holding company with nominal capital, to take over this real estate, as well as "other real estate" owned by the bank and in exchange therefor

give the bank stock in the holding company. This stock is to be carried in the "securities account" or as "other assets."

The plan as proposed is not approved and should not be carried out. It cannot be seen where the bank would benefit at all merely from the exchange of "other real estate" for stock, which will be even less marketable. A holding company does not serve its purpose unless it actually relieves the bank by a cash purchase of assets removed through it.

The necessity for the organization of a holding company, however, with sufficient paid-in capital, to take out of the bank all of the real estate now owned and which it will have title to after the deeds and assignments of that owned by the Merchants National Bank have been completed, cannot be too strongly emphasized, and it is urged that a company be organized in accordance with this plan; also that the elimination through this source of assets other than real estate, which are of questionable character, be arranged.

On June 6, please advise what decision has been reached in this regard and whether you have been successful in selling any of the real estate owned or have prospects for sales.

At the same time state what has been decided in regard to change in management or whether instead you have procured the services of an able collector. Under either circumstance please state what results have been obtained in the way of collection of slow and doubtful loans and realizing on other slow and doubtful assets up to that time.

A report from you as to what has been done to overcome the other criticisms mentioned on

supplemental sheet 11 is also desired and you are requested to attach a copy of your daily statement as of June 6 for comparative purposes, forwarding duplicates of letter and statement to Chief National Bank Examiner T. B. Harris, 1103 Alexander Building, San Francisco, Calif., and National Bank Examiner M. C. Wilde, 238 Central Bldg., Seattle, Wash.

Respectfully,

(Signed) E. W. Stearns,

(r. 129-132) *Deputy Comptroller.*

In response to this communication of the Comptroller's office at a regular meeting of the Board of Directors on the 9th of May, 1926, O. L. Price, Phil Metschan and Emery Olmstead were requested to call upon the Comptroller of the Currency at Washington, and on May 24, 1926, the Board, McDougall, Price, Collins, Charlton, Metschan, Pittock Stewart, Skinner, and Spalding, signed a letter to the Comptroller saying that Price, Chairman; Olmstead, President, and Metschan, Director, would call upon the Comptroller for a personal discussion, to reach Washington, Monday, June 7, 1926.

On the 22nd of October, 1926, T. E. Harris, Chief National Bank Examiner for the 12th Federal Reserve District, wrote Olmstead, President, the results of his examination of the bank at the close of business, September 21, 1926, and submitted schedules and informed Olmstead as President that his officers had not concurred in the classification that he had made, but that the condition

of the institution as he saw it presented was that *"Estimated losses impair your capital in the sum of $237,460.78, the only legal means for the restoration of which is an assessment which would not only cause unfavorable comment but would leave the bank without a surplus fund."*

The Examiner's report at this time showed non-bankable paper more than $200,000.00 *in excess of the capital surplus and undivided profits and in addition doubtful assets and losses amounting to enough to make up* $4,070,000.00, and Examiner recommended that it was entirely inadequate to do otherwise than to remove all possible losses and doubtful assets so that *the bank might take its proper place among metropolitan institutions.*

Following this, December 2, 1926, the Comptroller, himself, wrote the Board of Directors referring to the Harris report of September 21st, 1926, and which was completed on October 22, 1926 in which he called attention to the impairment of capital and expressed a doubt as to whether the sum of $1,000,000.00 would be sufficient to remove objectionable assets and it was requested that a special meeting be called to give the Examiner's report consideration, saying that they desired to cooperate with the Board to as great an extent as was consistent with its responsibility and would in the meantime withhold issuance of a formal impairment notice pending receipt of ad-

vices regarding the plans for meeting the situation. Particular attention is called to this letter of the Comptroller written December 2, 1926, in view of the testimony of the defense.

Between the 18th day of May, 1926, and throughout the year 1926 the minutes of the Board of Directors did not show that the Board considered the Examining Committee's report, and there was no report considered by any of the Board of Directors at any of the Board meetings until February 16, 1927 for the year 1926.

On December 11, 1926, the Board of Directors held a special meeting about the Harris report of September 21, 1926, and Harris himself was present, and the following proceedings were had:

> "At a special meeting of the Board of Directors of The Northwestern National Bank of Portland, held this date, there were present Messrs. O. L. Price, Emery Olmstead, A. D. Charlton, Phil Metschan, C. K. Spalding, F. F. Pittock, R. S. Collins, Natt McDougall, Chas. H. Stewart and M. Skinner, Mr. Price presiding.
>
> *Mr. T. E. Harris, Chief National Bank Examiner of the Twelfth Federal Reserve District, attended the meeting and discussed with the members of the Board his recent examination of the affairs of the bank. The various items listed for comment and criticism in the Examiner's letter of October 22nd were given special attention, and the suggestion that a company be organized for the purpose of re-*

moving from the bank certain slow and criticized assets, was approved by the Board substantially as outlined in said letter.

There being no further business to come before the meeting it then adjourned.

(Signed) O. L. Price,
Chairman."

Skinner identified and read into the record report of Examiner Wilde of March 25, 1926 with respect to the large lines the complete history of which was shown by this report as identified by the witness, as follows:

"J. E. Wheeler, direct loans	$236,000.00
J. E. Wheeler (sundry drafts in bills in transit) discounted	99,100.00
McCormick Lumber Company (protested checks in cash items)	36,503.50
Wheeler-Olmstead Company (protested checks in cash items)	11,000.00
Wheeler Timber Company	97,500.00
W. E. Wheeler Estate	95,500.00
Telegram Publishing Company	120,000.00
Overdraft	261.78
L. R. Wheeler	106,500.00
	$802,365.28

Loans to J. E. Wheeler unchanged since previous examination, again classified as slow.

Sundry drafts in transit, discounted by J. E. Wheeler, are drawn by J. E. Wheeler on W. M. Wheeler, of San Francisco, the Wheeler Timber Company of San Francisco, and William Smearbaugh, of Pennsylvania, while not classified in this report, *are carried in an ac-*

count "Bills in Transit" and should be carried in Loans and Discounts. One draft for $21,000 drawn on W. M. Wheeler is a renewal.

The McCormick Lumber Company protested checks and the Wheeler-Olmstead Company protested checks, *both carried as cash items,* were eliminated during the examination, having been taken up *by J. E. Wheeler and the McCormick Lumber Company. The original checks were payable to and credited to the account of J. E. Wheeler, and at this examination classed as an excess loan, with the direct liability of J. E. Wheeler.* (See Excess Loan Schedule.)

Loans to the Wheeler Timber Company, the W. E. Wheeler Estate, and the Telegram Publishing Company, all secured with a guaranty of J. E. Wheeler, are unchanged since the previous examination, and all classified slow in this report.

Loans to L. R. Wheeler, who also guaranteed the loan to the Telegram Publishing Company, are unchanged since the previous examination, and again classified slow.

The only change in the entire line since the previous examination is the elimination of the McCormick Lumber Company's indebtedness of $86,500, which was paid through proceeds of a bond issue, *and the addition to the line of the discounts and cash items listed above.*

At the previous examination J. E. Wheeler made an assignment to the Portland Trust Company, as trustee, of his one-eighth interest in timber lands situated in Tillamook county, and one-sixteenth interest in timber lands situated in Yamhill county; also the following stock to secure his entire direct and indirect indebtedness to this bank.

88 shares of Silver Fork Lumber Company.
40 Shares of W. H. Peters Logging Company.
43 Shares of McCormick Lumber Company.
255 Shares of Browns-Wheeler Company.
380 Shares of W. E. Wheeler Company.

This collateral was also pledged as a secondary lien to an indebtedness owing a bank in San Francisco, where it is said the agreement had been forwarded but not returned. President Olmstead gives assurance that Wheeler has arranged his affairs so that a material reduction will be obtained on this line within the near future, either through sale of some of Wheeler's holdings, or a bond issue against the same." (r. 302-304)

That this report also referred to the David Michellvi Sheep Company, and the witness showed that there was listed on that account $350,212.06, including overdraft and investment in stocks and bonds in behalf of the bank, and that as of March 25, 1926, with respect to Dufur Fruit & Farm Company $295,565.68.

Thereupon the witness produced the report of the Bank Examiner T. E. Harris of September 21, 1926, and therefrom informed the Court that the total amount of assets scheduled for examination and *considered non-bankable was* $2,621,240.05, and that the amount then doubtful was $490,468.74; that the amount of slow was $809,747.25; and the witness was then asked if this report showed anything about the Michellvi Sheep Company and the Dufur Farm & Orchards, and the witness then read

from the report as made to the Bank and communicated to the directors the following information as then given in evidence:

> "A. September 21, 1926, Item 7: Under 'Criticism.' *Lenient credit policies which have not only resulted in heavy losses but have carried this institution entirely beyond its legitimate field of banking and made it a partner* and in some instances sole owner of other business which it now directly or indirectly operates. I may refer to, (a) Bi-State Invesment Company, $501,985.55; (b) Dufur Farm and Fruit Co., approximately $300,000; (c) Bavin Michellod Sheep & Land Co., $321,150.00; (d) two-thirds interest in Boulder Creek Lumber Company $77,490 (in addition to a small loan); (e) M. L. Jones-Oregon Agricultural Co. lines $244,681.63; (f) Kelly Ranch Line approximately $190,000. *The foregoing items aggregate more than* $1,500,000, *and are investments which your examiner considers as entirely outside the purpose for which banks are chartered.*" (r. 306)

On January 11, 1927, Charles A. Morden placed in nomination Charlton, Collins, McDougall, Chauncey McCormick, Olmstead, Pittock, Price, Skinner, Spalding, Stewart, Twohy and Metschan.

And in view of the evidence of the defense, the Court should notice and be informed that on January 11, 1927, the Comptroller's letter of December 2, 1926 was then read to the Board, and at the same time the official copy of the Harris report of September 21, 1926 was presented to the Directors

according to the official record of the bank, and no action was taken by the Board.

On the 2nd day of March, 1927, the officers and directors of The Northwestern National Bank caused to be published on the first page of the Morning Oregonian and given out a statement by the bank as follows, to-wit:

STATEMENT BY THE BANK

The Northwestern National Bank announces that the Pittock estate has acquired a larger measure of interest and control in the bank corporation.

Associated with the Pittock estate in ownership and operation of the bank are Messrs. E. S. Collins, A. D. Charlton, Chauncey McCormick, Natt McDougall, Phil Metschan, Frederick F. Pittock, O. L. Price, Mark Skinner, Charles K. Spaulding, Charles H. Stewart and James F. Twohy, directors, all well known in Portland, and the Northwest as men of affairs.

O. L. Price has been elected president of the bank and will have active charge of its business. It will continue to serve the public as a financial institution of first importance and known responsibility.

On the 5th day of March, 1927, another examination of the bank was made by Chief Examiner Harris. This report of Harris is in the record and is one of the Exhibits, but it suffices to shorten the labors of this court by referring to the letter of the Directors of the 18th of March, 1927,

which they wrote to the Comptroller of the Currency at Washington, as follows:

"March 18, 1927.

Comptroller of the Currency,
Washington, D. C.
Sir:

Following the completion of his examination of this institution as of March 5, 1927, Chief Examiner T. E. Harris has invited our attention to the various matters herein referred to with the request that we write you concerning them:

Losses estimated, $2,446,769.65.

This estimate of losses is in excess of the capital, surplus and profits by $2,859.10, and makes necessary an assessment of 100%. *We are unanimous in the request that you immedately issue formal notice of impairment of capital,* together with the necessary instructions, that we may proceed to collect the assessment if we find that we cannot obtain unanimous consent of shareholders to voluntarily restore the capital.

Losses estimated will be charged off and an account opened "Due from Stockholders on Account of Assessment," which will be charged $2,000,000. In the event a report of condition is called for prior to the collection of the assessment, this item will be shown as "Other Assets" as instructed by your Examiner.

The payment of an assessment of 100% has guaranteed by certain responsible shareholders, a copy of which guarantee is submitted herewith.

This bank has been under criticism from your Department for a number of years and particularly so since the acquisition of the old

Merchants National Bank's assets. It has acquired a volume sufficient to produce a splendid net profit on operations. With the elimination of nearly $2,500,000 of income producing assets its earnings should be materially improved, so that earnings of 15% or more may be confidently expected. *We assure you that the credit policies of this bank henceforth* will be conservative so that earnings may be used for dividend purposes and reflected in individual profits, after eliminating any losses that may possibly develop in assets now owned, though we believe these, if any, will be offset by recoveries.

The assessment destroys our surplus fund of $400,000. With all our past difficulties we have succeeded in maintaining the confidence of the public. It is apparent now that we are losing a few small accounts, chiefly savings accounts. This is a situation that is hard to meet. We do not want to go to the public with a published statement showing no surplus. *We have no fault to find with the classification of assets made by your examiner,* though we do believe that in time we will make substantial recoveries on certain items estimated as losses. We admit all items so classified are non-bankable and should be removed.

It is our desire to put all charged off assets into a corporation, all of the stock of which will be trusteed for the benefit of shareholders of the bank, and have this corporation execute its note to the bank for $400,000, which amount will be put into recoveries and transferred to surplus. Your Examiner has agreed with us to recommend that we be permitted to do this, with your approval, provided the note be made to mature in two years, when it must be eliminated, and, provided further, that each

of the directors will unconditionally guarantee that after applying all recoveries from the assets owned by this corporation, and after applying all undivided profits on hand on the date of the maturity of this note (keeping the $400,000 surplus fund intact) any balance due thereon will be taken up by the directors individually.

Our only objection to this program is the fact that some of our directors are men of large affairs, who sometimes borrow for themselves or use their credit for the benefit of their respective interests, and the liability incurred as above would detract from their financial statements and hamper them in their individual efforts. We will appreciate a counter suggestion from you, as to how this problem may best be solved.

It has been brought to our attention that losses have been estimated on loans classed as excessive, *and the directors have been requested to remove these losses personally.* We are furthermore advised that under a law a director becomes personally liable for such losses upon a suit by any shareholder or a receiver, when the loans were approved or acquiesced in by him and under a proper showing of negligence. *We do not admit any liability in this connection.* While there are excessive loans in the bank there are mitigating circumstances and at least one of the loans *became excessive in direct violation of a resolution* of this board.

Your examiner has informed us that the only legal means for the restoration of capital in a national bank is by way of assessment—the only means he can insist upon He has seriously recommended, however, that we consider the organization of a new institution,

which he assures us can be accomplished in a very short time, to take over the business of this bank. By this method it is pointed out that we may now provide a surplus fund—making an announcement to the public that should inspire confidence, *avoid the comments incident to an assessment* (which must cover a period of some fourth months) *and the advertisement and sale of stock of delinquent shareholders.* We will give this suggestion full consideration, but at present we want to proceed with an assessment on the stock.

Some months ago you suggested that we consider a change in the management. A change recently occurred by the resignation of one of our active officers whom we believe to be the one referred to in your letter.

Respectfully

H. Skinner
E. S. Collins
C. K. Spaulding
Natt McDougall
Chas. H. Stewart
O. L. Price
A. I. Charlton
Phil Metschan
James F. Twohy
F. F. Pittock

(r. 166-169) *Directors.*

On the 29th of March, 1927 at 9:00 o'clock A. M., Price, Collins, Metschan, Spalding, Charlton, Skinner, Stewart, and McDougall present, the Directors held a special meeting. Price presided and Skinner was Secretary. Directors McCormick, Pittock and Twohy were absent from the state, and the draft of contract between the Northwestern Na-

tional Bank on the one part and First National Bank of Portland and United States National Bank of Portland on the other part, providing for the sale of all assets of the Northwestern National Bank was presented to the Board, and Phil Metschan moved and Charlton seconded his motion that the President and Secretary be authorized and directed to execute and deliver this contract, and thereupon Spalding moved and Stewart seconded his resolution, "*That, whereas, various stockholders had made advances to the bank in the aggregate of a million dollars to be held by the bank as a guarantee for the payment of various and sundry obligations owing to said bank which have heretofore been criticised as undesirable assets of said bank, etc.*

WHEREAS by virtue of said advance of said stockholders, the said bank became indebted in the amount above set forth.

NOW, THEREFORE, be it resolved that the officers of said bank be and they are hereby authorized to execute and deliver to MARK SKINNER as Agent representing said stockholders who have made such advances, a non-negotiable promissory note of this bank in said sum of one million dollars, payable upon demand after all liabilities of said bank to its depositors and others than to said stockholders, shall have been paid.

Thereupon a resolution was unanimously adopted by the vote of all the directors present.

Thereupon a resolution was offered by Mr.

Phil Metschan who moved its adoption, which motion was seconded by Mr. Natt McDougall, which resolution is in words and figures as follows, to-wit:

WHEREAS, C. A. Morden and O. L. Price, Trustees of the Estate of Henry L. Pittock, have paid to the Northwestern National Bank of Portland, Oregon, the sum of one million ($1,000,000) dollars.

NOW THEREFORE, be it resolved that the officers of said bank be and they are hereby authorized to execute and deliver to said C. A. Morden and O. L. Price as such Trustees, the non-negotiable promissory note of this bank in the sum of one million ($1.000,000) dollars, payable upon demand after all liabilities of said bank to its depositors and to others than its stockholders, shall have been paid.

Thereupon said resolution was unanimously adopted by the vote of all the directors present.

There being no further business the meeting thereupon adjourned.

(Signed) M. Skinner,
Secretary.

The form of this contract referred to is as follows:

"To First National Bank of Portland, Oregon, and United States National Bank of Portland, Oregon.
Gentlemen:—

The undersigned, The Northwestern National Bank of Portland, Oregon, hereby proposes to sell, assign and convey to you all of its assets of any name and nature in consideration

of your assuming and agreeing to pay all of its liabilities, including liabilities to depositors, but excepting from said agreement to assume and pay two certain notes bearing even date herewith each non-negotiable in form; one for one million dollars ($1,000,000 payable to C. A. Morden and O. L. Price, trustees, and the other for one million ($1,000,000) payable to Mark Skinner, agent, executed by The Northwestern National Bank of Portland; and excepting any liability to any share-holders of said Northwestern National Bank of Portland. It is further understood that you will liquidate and convert into cash all of the assets so sold and transferred which may be necessary to pay those liabilities so assumed by you and the reasonable expenses of such liquidation and shall thereupon re-assign and re-convey to the undersigned all such assets then remaining.

It is especially agreed by C. A. Morden and O. L. Price, trustees, and Mark Skinner, agent, that if said assets so sold and transferred shall be insufficient when liquidated to pay each and all of said liabilities so assumed, said notes and each of them shall be held for naught as to said First National Bank and said United States National Bank, and to evidence this agreement, C. A. Morden and O. L. Price, trustees, and Mark Skinner, agent, hereunto set their signatures as such. Your acceptance of this proposal shall vest in you the title to all such assets and shall bind you to assume and pay the liabilities above assumed but not those especially excepted as aforesaid. The Northwestern National Bank of Portland hereby guarantees to First National Bank and United States National Bank each and every asset so turned over and delivered, which guaranty shall

be prior in right and prior in time to any liability by Northwestern National Bank upon said non-negotiable notes to C. A. Morden and O. L. Price, trustees, and Mark Skinner, agent.

This instrument is executed pursuant to the unanimous vote so authorized, of a majority of the Board of Directors of the Northwestern National Bank, as appears in the records of said Board in its minute book and by the signature of said Directors appended hereto.

Said directors further agree to forthwith call a special meeting of the stockholders of The Northwestern National Bank for the purpose of adopting a resolution or resolutions ratifying the sale aforesaid and this agreement and the passage of any other resolutions germane thereto. Stockholders holding the number of shares of the outstanding capital stock of The Northwestern National Bank of Portland set opposite their respective names, join in the execution hereof as evidence of their approval thereof and append to their signatures the number of shares they respectively own and hold therein, and agree at said special stockholders' meeting to be called for said purpose, to vote affirmatively upon resolutions approving said sale, and this agreement and any other resolutions germane thereto.

Yours very truly,
The Northwestern National Bank of Portland
By O. L. Price,
President.

Corporate Seal
Attest M. Skinner,
Secretary.

The foregoing proposal is hereby accepted:

The United States National
Bank of Portland
By J. C. Ainsworth,
President.

The First National Bank of
Portland
By A. L. Mills,
President.

Dated March 29, 1927."

The notes referred to are as follows:

Portland, Oregon, March 29, 1927.

For value received the Northwestern National Bank of Portland, Oregon, promises to pay to the order of Mark Skinner, Agent, the sum of one million dollars ($1,000,000) with interest at the rate of six per cent per annum from the date hereof, payable on demand, when and only when from the proceeds of the liquidation of the assets of said payer this date transferred to the First National Bank of Portland and the United States National Bank of Portland, all pursuant to contemporaneous guaranty of the payers, said last named banks have realized sufficient to fully liquidate the liabilities of the payer assumed under contract of even date with the payer. In case suit or action is instituted to collect this note or any part thereof, the said corporation promises to pay such additional sum as the Court may adjudge reasonable as attorney's fees in said suit or action. In witness whereof the said corporation under authority of resolution of its

Board of Directors has caused this note to be executed by its duly authorized agents.

THE NORTHWESTERN NATIONAL BANK
OF PORTLAND
By O. L. Price,
President.

The other note is similar in form, made to Price & Morden, trustees, for the same amount.

There were no meetings of stockholders of the bank called, there were no notices sent out to accomplish what the Directors did on the 29th of March or to get previous authorization so to do, and the only notices that were sent and the only meetings that were held were those with respect to matters concerning liquidation afterwards held and by notices subsequently sent. The record shows:

Mr. Hampson: We will admit no formally called meeting of the stockholders except as shown by the records.

Mr. Logan: Admit no call.

Mr. Hampson: No formal call for stockholders meeting except as disclosed by the records.

Mr. Bristol: From March 29th.

Mr. Logan: They are all in evidence.

Mr. Bristol: Then I understand that you mean, Mr. Hampson, do I get this precise as between you and Mr. Hart, that both of you stipulate that there was no called deliberate assembly of the stockholders after January 11, 1927, until the meeting that appears in the record of May 3, 1927, is that right?

Mr. Hampson: I can't exactly say were no stockholders meetings. I said that no stockholders meeting was called in the manner provided for by the by-laws except as the record of such stockholders meeting appears in the record book which is already in evidence.

Mr. Bristol: You agree with that Mr. Hart?

Mr. Hart: Yes, I go further; I will say was none between the dates you specify; the record so indicates.

Mr. Bristol: Mr. Hampson, don't say that.

Mr. Hampson: I will go further than that; I have no doubt that the stockholders met and discussed the affairs of the bank but not called as provided by the by-laws to make what would be technically called a stockholders meeting." (941, 945)

The published statements given out by the Bank Directors of the Bank's condition on each successive call from September 15, 1922, down to and inclusive of March 23, 1927, six days before the bank ceased business, March 29, 1927, which statement was published March 28, 1927, in the Oregonian, were offered and received in evidence, up to No. 51, inclusive. These exhibits were offered serially from No. 30 to 51, inclusive.

Exhibit No. 30 was shown the witness, Paul S. Dick, as the published statement of March 23, 1927, purporting to show under oath and exhibiting the $2,521,676.17 composed of the capital, surplus and undivided profits of said bank at that date, and

Dick was asked whether the discovered losses as of March 29, 1927, would wipe out the entire amount and his testimony was that it would take $6,400,000.00 cash to have reinstated the bank's condition at that time.

These exhibits showed in the publication for the call of December 31, 1924, the amount of *capital, surplus, and undivided profits* were given $2,499,-317.81 by authorization of the Directors.

Similarly the published situation of September 28, 1925, was $2,596,730.18;

or December 31, 1925, the amount published was $2,486,913.45;

For the published condition on the call of April 12, 1926, amount given as $2,519,148.29;

For the call of June 30, 1926, it was published as $2,508,362.21;

And the publication for the call of December 31, 1926 carried the amount of $2,452,570.48;

And for the call which was made March 23 and publication referred to as of March 28, 1927 above, the amount was $2,521,676.67.

Fraley who was Auditor and Cashier, made up a statement which is Complainants' Exhibit 31, and upon this exhibit the Court will notice that the capital surplus and undivided profits for the 29th

of March, 1927, is given as $2,430,026.82. The testimony of Mel Young went into these and other figures.

Without argument the Court is asked to note that the published statement as put out and which Fraley testified he took care of, made in the Oregonian on March 28, was $2,521,676.67.

Now we come to the Comptroller's photostatic copies of the statements of assets and liabilities received by him and certified over the signatures of Olmstead, Price and Pittock, sometimes Charlton, Metschan and Pittock; sometimes Olmstead, Price and Charlton, and Stewart, Price and Charlton, consisting of Exhibits numbered consecutively 32 to 49, both inclusive, and being the period of time for the same calls as published statements were made in the Oregonian for similar dates commencing with September 15, 1922 and ending on the 23rd day of March, 1927, which Exhibit 49 was offered in connection with Exhibit 90 already in evidence.

These exhibits disclosed that the return made to the Comptroller on the call for December 31, 1924, was $2,480,198.74, being the capital, surplus and net undivided profits and sworn to by Olmstead, Price and Pittock;

And that for the call for September 28, 1925, it was $2,524,639.95;

And for the call of December 31, 1925, $2,470,-218.16;

And for April 12, 1926, Exhibit 46, $2,437,226.71;

For the call of June 30, 1926, $2,490,202.43;

And for the call of December 31 1926, $2,430,-026.82, Exhibit 48;

And for the closing report of condition of March 23, 1927, Exhibit 49, $2,456,800.66.

It needs but the inspection of these figures to show the differences between what were deliberately sworn to in the returns to the Comptroller against the figures in the published statements on each call; most of which and their source were testified to by MEL YOUNG, the bookkeeper. (St. p. 146.)

These discrepancies between the reports to the Comptroller and published statements at each call of the condition of the bank are vital and remain unaccounted for by any defense or evidence in the record. The amounts are easily computable and run into thousands of dollars as demonstrated by the evidence. For instance, for the year 1924, Nineteen Thousand Odd Dollars, for the year 1925, Eighty-eight Thousand Odd Dollars, for the year 1926, One Hundred Twenty-two Thousand Odd Dollars, and for the year 1927, approximately Sixty-five Thousand Dollars.

Exhibit 31, A. L. FRALEY, shows that with the capital impaired $9,400,000.00 was needed as of March 29, 1927. If the capital was excluded at $2,000,000.00, it still left $7,400,000.00 to be supplied; but we are told by the evidence that on March 1st there was a million put in and afterwards another million provided for, and on top of this a two million contingent liability of the stockholders.

MR. AINSWORTH, PRESIDENT OF THE UNITED STATES NATIONAL BANK, ONE OF THE TAKING OVER BANKS OF PORTLAND, OREGON, TESTIFIED THAT PROPOSITIONS HAD BEEN MADE TO HIM IN 1923 FOR CONTROL OF THE STOCK AT $150.00 PER SHARE, AND THAT ON MARCH 28, 1927, AFTER ALL NIGHT LONG GOING INTO THE BANK'S AFFAIRS WITH A CROWD OF MEN, IT WAS DISCOVERED THAT ALL OF THE CAPITAL SURPLUS AND UNDIVIDED PROFITS WERE SHORT BY ABOUT TWO MILLION OF PAYING THE DEPOSIT LIABILITY, THEN FOUND THAT IT WOULD TAKE ALL OF THE BANK'S CAPITAL SURPLUS AND UNDIVIDED PROFITS AT AN EVEN TWO AND ONE-HALF MILLION, AND A ONE HUNDRED PER CENT ASSESSMENT IN ADDITION, MAKING TWO MILLION MORE, OR FOUR AND ONE-HALF MILLION, AND THAT TO REINSTATE THE CAPITAL SURPLUS AND UNDIVIDED PROFITS WOULD REQUIRE TWO AND ONE-HALF MILLION

MORE, WHICH WOULD TAKE ABOUT SEVEN MILLION DOLLARS. THAT THE MILLION DOLLAR NOTES, TWO OF WHICH WERE INVOLVED IN THE TRANSACTION OF HIS BANK AND THE FIRST NATIONAL BANK AND WERE TREATED AS CASH BECAUSE MR. PRICE DELIVERED THE EQUIVALENT THEREOF IN BONDS, AND THAT HIS BANK AND THE FIRST NATIONAL DID NOT TAKE THE NOTES BUT TOOK THE ACTUAL BONDS.

MR. PAUL S. DICK, one of the officers of the United States National Bank, corroborated Mr. Ainsworth that the first negotiations of sale were in February, 1923, and he was shown the statement, Exhibit 30, and asked whether it contained the figures of the published statement of the bank that he received from O. L. Price. Mr. Dick replied that Price had given them the figures of the report of the National Bank Examiner, Mr. T. E. Harris, under the date of March 5, 1927, and upon suggestion by Mr. Hart, the witness corrected his testimony to say that the Harris report he probably referred to was one of September 21, 1926, but that taking the complainants' Exhibit 30 as indicative of the condition as of March 29, surplus and undivided profits at $2,521,676.17, Mr. Dick stated that the discovered losses would wipe out the entire amount, and that it would have taken $6,400,000.00 cash to have reinstated the bank's condition at that time.

The Court will remember that Exhibit 30 is the published statement made in the Oregonian March 28, 1927, on the call made March 23, 1927.

LONGSHORE, one of the officers of the bank, testified that Mel Young was the general bookkeeper and kept the records of the bank up to the time it closed, and that if anybody wanted to find out the state of the bank finances, that was the record that they would go to and which would tell from day to day the condition the bank was in, and that was always kept. That the overdraft book was left for the convenience of the officers on Mr. Jones' desk. The witness then went with much detail into the manner of examining the bank and said that the practice was to actually come in contact with the physical papers themselves, and that when items were to be traced of one sort or another, they went to the departments to trace them, and it was just as easy for anybody so doing to be able to see what he saw as well as what other officers of the bank saw.

On June 10, 1926, he wrote J. E. Wheeler a letter, as follows:

June 10, 1926.

Mr. J. E. Wheeler,
Care of Telegram Publishing Co.,
City.
Dear Sir:

We acknowledge receipt of personal guarantee given by yourself to this Bank under date

of June 8, 1926, covering loans made by this Bank to the McCormick Lumber Company, up to $240,000.00.

This guarantee is a continuing guarantee and under same we may continue from time to time to make advances to the McCormick Lumber Company up to $240,000.00.

Yours very truly,
A. C. Longshore,
Assistant Vice President.

This witness identified the McCormick Lumber Company account as the Complainant's Exhibit 2 as it was compared with the records of the bank, and the photostat sheets were offered in evidence. The witness then explained that this account showed its opening in March, 1926, and the continuance of the transactions with that account through the bank, and that it was part of the general books of the bank.

THERE WAS NOTHING TO PREVENT ANY OFFCER OR DIRECTOR OF THE BANK DURING THE PERIOD FROM MARCH, 1926, FROM ASCERTAINING AND KNOWING WHEN HOYT, BROWN, BATES AND HIMSELF TALKED ABOUT IT, WITH RESPECT TO THE WHEELER-McCORMICK LUMBER COMPANY "CASH ITEM" CHECKS. *Hoyt had showed him a list of the checks in July and some in August that were returned unpaid.* Mr. Bates had taken the matter up with Mr. Skinner and he had seen Bates a number of times take it up with Olmstead—almost daily. *Anybody in that bank was in the same position for general knowledge as the witness himself was.*

That before the bank closed there were extensive rumors of the sale of the bank. On the street cus-

tomers had spoken to him about it, and the first time he had heard of a sale of the bank was in 1923, the same sale that Mr. Ainsworth had talked about; that his fellow officers had discussed it with him after the first of the year 1927. Also Mr. Bates, Mr. Brown and Mr. Hoyt, and that the rumors of the sale which the witness had heard came before the discovery of the float and before the change of presidents on March 1, 1927, when Price succeeded Olmstead.

The stock deal:—

Exhibit 11 was signed by Ballin and John Twohy and No. 60 was signed by Wheeler, Olmstead, Collins, Burckhardt, Skinner, Stewart, McDougall and J. O. Elrod. The first time that Burckhardt had seen Exhibit 60 it had three signatures on it, Wheeler, Olmstead and Collins, and the witness signed after Collins. When Burckhardt had talked with Skinner, Olmstead and Metschan, that Skinner had told him that there was a movement on by the Pittock Estate to get control of the Bank and sell it to the First National, and that they wanted to prevent that. These Exhibits 11 and 60, were the papers by which each signer agreed not to assign or transfer his stock, unless a majority of those signing should consent to the sale.

Olmstead had taken an option on Ballin's stock as early as March, 1925, and that was the same stock referred to in the letters of 1927, between Olmstead and Ballin, and Burckhardt had been approached by Olmstead to sell his stock for $140.00,

but Pittock had bought some stock from Lindner in the early part of 1927 at $120.00 a share.

DECKER worked in the Collection Department and noticed collections on account of the McCormick Lumber Company that commenced shortly after 1925, coming back every two or three days, and they would be thrown in "Cash Items" and he noticed that they were increasing; that he always referred the items to George Hoyt, the Assistant Manager in the Department, who was his superior officer, and to Mr. Fraley, the Auditor and Cashier of the bank, and upon question by the trial court the witness explained that "Cash Items" are part of the Bank's assets. *The Collection Items do not show on the bank's statement at all, but the "Cash Items" do.* He always showed the returned Cash Items to Mr. Hoyt and he told Olmstead when any items came back; that Fraley or Mr. Bates, or anyone, could go into the Department and make a list of the items; that the McCormick account was held all of the time until the bank was able to get a check to cover what had been charged to Cash Items, and the account was handled this way all of the time as everybody knew it, and that these Cash Items had to be taken in consideration to arrive at the bank's condition all of the time each day, *and there was nothing to prevent any officer or official of the bank acquiring the same knowledge that Decker himself had during the periods of the transactions;* that these items denominated "Cash

Items" as the account was opened in March, there were lots of them; *they were all right on the sheets, complainants Exhibit 2.*

The daily statement of the bank necessarily had to show the total of "Cash Items" at the end of each day's business. When the Examining Committee was looking into the Bank's condition, the Cash Items were listed in the usual way and they were handed to Mr. Fraley that he might go over them with the Examining Committee; that he turned his lists over to the General Bookkeeper, Mel Young, and that Mel Young would make entries on the bank books.

RINGSRED, HOYT, JONES, BATES AND HORSTMAN all practically testified to the same effect, amplifying Longshore's explanation and Fraley's methods of audit, and it thus appeared that as early as July and certainly before August, the attention of the bank officials was called to the large amounts of Cash Items that were moving through the Wheeler and McCormick Lumber Company transactions in this bank. And the bank records showed in connection with the daily statement book prepared by Mel Young and always open to investigation by all of the officers, and by the overdraft book always kept on Jones' desk, and by the list of Cash Items kept in the Collection Department, through Horstman direct, and under the guidance of Hoyt, *that that was the avenue of con-*

stant information as the evidence discloses, showing that as the Examiner had heretofore stated on previous transactions as hereinbefore shown, the accounts called "Sundry Bank," "Cash Items" and "Bills in Transit," progressively grew and increased commencing in May 1926, *and down through and inclusive and up to March* 2, 1927; *that these figures were open and observable to anybody from clerks on through to subordinate and in to superior officers whose particular attentions were called thereto, and that these items ran into an increasing million, being in all* $1,100,000.00, *rising in September to over* $2,000,000.00 *with gradual progression for* 1926, *and in October to over* $2,000,000.00, *and approaching* $2,000,000.00 *in November,* 1926, *when particularly on November* 19, 1926, *under testimony of Fraley, the report of the Examining Committee showed* $1,833,084.84, and in January, 1927, the items had fallen a little but remained on January 17, 1927, at $1,7000,000.00 odd, and on February 16, 1927 Cash Items were approximated $800,000.00 and Sundry Bank Account nearly $1,700,000.00; *and on February* 28 *the Cash Items were* $823,000.00. *On March* 1*st, however, the same Sundry Bank Items had been stated by Mel Young, bookkeeper, to be* $1,242,522.36. *The difference between the amount on March* 1*st, and the amount on March* 2*nd is obviously* $796,762.00 *in the account of Sundry Banks,* which is the amount of the alleged and much talked of kite or float of the Wheeler-Olmstead transaction.

On March 2nd, a Cashier's check was made by the bank to Mark Skinner for $922,100.00, and on March 2, 1927, an entry was made in the Stockholders' Account of $929,600.00, and a credit was given to Price, the president, of $7,500.00, the difference between the entry to the Stockholders' Account and the credit to Price, being $922,100.00, the amount of Cashier's Check held by Mark Skinner.

The knowledge and means of knowledge of these transactions were known to everyone in the bank, and recorded upon its books, and the $922,100.00 Cashier's Check is the amount denominated by O. L. Price in his testimony as the "first mililon."

The evidence shows by Exhibit 2 that the total transactions between March 29, 1926, and March 1, 1927, of McCormick Lumber Company and Wheeler were $13,354,976.03, and the other side of the account shows that there were returns from this vast amount of Items some $12,320,000.00, and the difference would represent approximately what has been paid.

Taking the items in connection with the bank's statement book so specifically described by MEL YOUNG, the bank's bookkeeper, the total withdrawn money and credits in connection with the Complainants' Exhibit 2 would indicate $1,672,-000.00, and the total paid about $876,000.00 leaving $796,762.00 as before in accordance with the entry of March 2nd, as the summated result of the trans-

actions over a period of a year. The basis for these figures appears in the statement of the evidence, page 144, and following.

OLMSTEAD testified that the Pittock Estate practically controlled the bank through Price and Morden, trustees, and that just before he resigned as president, Price was negotiating with the First National Bank for the disposition of the Northwestern National and that some time in 1925, Price and Morden had wanted to sell the Pittock stock for $125.00, and the reason they had written up the property account for the bank building at $490,000.00 was so that they could secure funds to take care of the frozen assets of the bank, that Price had objected to any method for taking the frozen assets out as proposed by Wilde in 1925, AND THAT THE BANK WAS TAKING ON NEW LOANS ALL OF THE TIME IN 1926 and 1927; that many people had said they did not want to stay in a bank when they did not know where the control would go, *and these things were very harmful to the bank;* that Morden's efforts to sell the bank commenced as early as 1923; *that there had not been any Executive Committee or Directors meetings at which to his knowledge there had been any suggestion about selling the bank;* that the bank's affairs were exhibited to the First National and United States National, and the Comptroller's Report of September 21, 1926, as made by Mr. Harris was also disclosed, prior to the time that he, Olm-

stead, left as president. This was done by Price, *and that although Mr. Morden was not a director of the bank* at the time of attempting to force Wheeler to sell the Telegram, *yet as a Pittock trustee and manager of the Pittock Estate in connection with Price he directed the policies of the bank.* Olmstead as president said the Complainants' Exhibit 2 recorded the transactions of McCormick Lumber Company with the bank, and he said that usually both checks went into the account and were credited as well as checks that came in transit and came back unpaid were ultimately carried as Cash Items, and *that any department that carried these items could be seen as indicated, daily and monthly.* The witness then testified about the transactions with the Wheeler business in 1924 in which there were checks and drafts unpaid and that Skinner and Stewart handled the matter along with him, and it was not done any different way in 1926 after it started in March, 1926; **THAT IT WAS IN JULY 1926 THAT HE AS PRESIDENT KNEW FOR THE FIRST TIME THAT CHECKS IN ANY VOLUME WERE COMNG BACK, AND THAT HE THEN CALLED MR. PRICE INTO HIS ROOM AND TOLD HIM ABOUT IT. THAT HE AND PRICE DISCUSSED THE AMOUNT OF THESE CHECKS AND HE TOLD PRICE AS CHAIRMAN OF THE BOARD THAT THE TOTAL AT THAT TIME WAS SOMETHING LIKE $200,000.00 AND THAT HE FIXED THIS TIME IN JULY OR THE FIRST OF AUGUST, AND THAT PRICE AND HIMSELF WERE INFORMED THAT**

WHEELER WAS EXPECTING MONEY FROM OTHER SOURCES; THAT THERE WAS NO TIME WHEN ANY DRECTOR OR OFFICER WHO WANTED TO KNOW THE EXACT AND PRECISE SITUATION OF THE WHEELER RELATIONSHIP WITH THE BANK COULD NOT HAVE ASCERTAINED IT. That the Board of Directors had never discussed a change of management with him, that it had been his duty to go to the Comptroller for four consecuive years, and that when he got back in each instance he told his fellow directors that the Comptroller insisted on a more vigorous policy, but that there had never been a suggestion to him about a change in management. IT WAS NOT UNTIL AFTER THE CLOSING OF THE BANK, MARCH 29TH THAT OLMSTEAD WAS ASKED TO SIGN THE PAPER CONSENTING TO THE GUARANTEE WHICH WAS PERHAPS A WEEK AFTER THE CLOSING OF THE BANK, AND HE SIGNED THE PAPER AT THE REQUEST OF MR. KERR IN THE VAULT ROOM OF THE SECURITY SAVINGS AND TRUST COMPANY.

Exhibits 69 and 70 were introduced in evidence. Exhibit 69 is the Report by T. E. Harris, September 21, 1926, and Exhibit 70 is the report made by T. E. Harris, March 5, 1927.

COLLINS testified that in the year 1923 he paid $140.00 per share then for his Northwestern stock. He paid $137.50 for some of it.

SPAULDING testified that he could not recall any particular instructions given by him to Olmstead about what he should do concerning Wheeler, by the Board or anybody else, after the October 9, 1924 meeting, no more than what that resolution applied to that was put on the minute book at the time of the overdarft in October, 1924. He did not recall any other time, **BUT THAT WHEN THE EXAMINING COMMITTEE MADE ITS EXAMINATIONS EVERY FACILITY WAS PLACED BEFORE IT TO ASCERTAIN THE AFFAIRS AND CONDITION OF THE BANK.**

Both Olmstead and Metschan admitted the letters, and they were received in evidence as written by them respectively to Burckhardt and Ballin concerning their interests and the values of their stock, and what they should do with it and how Olmstead and Metschan each respectively would look after and conserve the interests of the complainants.

FRALEY, the bank cashier and auditor, among other things testified about the procedure of the Eramining Committee in November, 1926, as follows:

> that the Examining Committee, Messrs. Metschan, Charlton and Skinner had started their examination at the close of business November 19, 1926, and he had a statement in his pocket showing what that eramination was to cover; that the witness had written it up as he always

had done and it was usual for him to give that direction every semi-annual examination, and it read as follows:

MR. BRISTOL: Bank Directors' Examination. Assets and liabilities to be examined and statements to be furnished by auditing department. All cash to be audited by auditing department, for the directors, and with their assistance when possible. Bank securities examined and audited from statement of securities as shown by general ledger and security record." Then the words "Other real estate owned" is that your writing?

A. Yes sir.

Q: "Loans and discounts checked and examined from list furnished by note department and from liability ledger sheets themselves. *Cash items examined and checked to general ledger from list furnished by auditing department, along with Cash Recapitulation.*"

Court: You can read it right along; we will assume you read it right.

Q: "Verification letters sent to all C. H."

A: Clearing house banks.

Q: "Return letters given to directors with copy of settling statement. Examination of outstanding cashier checks, certified checks, time C-Ds, Demand C-Ds and Bills in Transit, *checked from lists made up by auditing department.* Expense and interest paid, condensed statement. Assets non-income producing, statement. Loans and discounts on which interest is not paid. Expense book and stock register examined by directors. And then in writing list of overdrafts. That is your writing?

A. My writing. (r. 695, 696)

And the paper that he prepared as auditor as above quoted was for the guidance of the Examining Committee at that time and, according to his suggestion, the Committee was required to go and look into the cash items, and that they did it and they had done so under his suggestion but he was not positive whether they did it November 19, 1926; and that on November 19, 1926, he gave them a list of the cash items, and the same was introduced as complainant's Exhibit 29.

The witness then produced three papers, consisting of two credit memoranda and one debt memorandum dated March 1, 1927, of the Northwestern National Bank and described them as follows:

"Q: The first item is credit stockholders assessment account, March 1, 1927, F. F. Pittock, $17,500; Phil Metschan, $10,000; E. S. Collins $76,000; O. L. Price special $7500; O. L. Price $29,000; Pittock Estate $769,600; Charles K. Spaulding $20,000. And paid and carried out as $929,600. And initialled "F". That is your initial?

A. That is my initial.

Q. And upon that same date, and as part of the same transaction, the next slip was Credit, Profit and Loss account, transferred from Stockholders Assessment. Account to take care of chargeoffs, $929,600, initial debt. Is that right.

A. That is right.

Q. Now then, the corresponding entry, or

the next part of the transaction is shown by debit slip. Is that right?

A. Yes.

Q. As follows: Debit, *Stockholder's assessment account,* March 1, 1927, F. F. Pittock, $17,500; Phil Metschan $10,000; E. S. Collins, $76,000; O. L. Price Special $7500; O. L. Price $29,000; Pittock Estate $769,600; Charles K. Spaulding $20,000.

A. That is right.

Q. Now the next in order.

A. They come in this way.

Q. Then the next in order gives a credit to Profit and Loss March 2, 1927, charge-off 3/1/27, account McCormick Lumber Company and J. E. Wheeler items, should have gone to Other Bonds, Stocks, Securities, etc. $796,762. Opposite that is written "Claims" and initialed "F."

A. That is right.

Q. There seems to be a lead pencil notation on that. What is that?

A. Mr. Skinner's initial.

Q. On March 2, 1927, debit "Other Bonds, Stocks, Securities, etc." McCormick Lumber Company and J. E. Wheeler Cash Items (see over for list) $796,762, Claims Accounts, and some initials.

A. That is right.

Q. Likewise initialed by Mr. Skinner in lead pencil?

A. Same initial, yes.

Q. And on the back of this are written the items that are referred to on the front of it?

A. That is right.

Q. Showing how the total of $796,762 was made up?

A. That is right.

Q. And is that your writing, or somebody else's?

A. My writing." (r. 704, 705)

The witness then read the items referring to the McCormick Lumber Company aggregating $92,-687.00; then the items similarly referring to McCormick Lumber Company in the Forest County National Bank, Tionesta, Pennsylvania $91,000.00, similar checks on Brookville Title & Trust Company, Brookville, Pennsylvania, aggregating $534,-475.00, and similar checks on Titusville Trust Company, Titusville, Pennsylvania, aggregating $75,-000.00.

It is immdeiately observable to the investigator of fact that if these items on these various banks are added together as those compiled by Fraley and handed to the Examining Committee (Complainant's Exhibit 29) they total $793,162.00, a difference of $3,600.00 from the amount $796,762.00 dealt with on the books March 2, 1927, of which the Examining Committee thus had information in November, 1926.

The witness Fraley then further testified by question and answer on this subject as follows:

"Q. The third group that relates to the ones we first read comprises total sum of $929,000, denotes somewhat of a corrective entry, does it not?

A. The first item of $7500 is correcting entry showing refund to Mr. Price for over-payments on stockholders assessment.

Q. And the second one?

A. The second represents the transfer of stockholders payments on that, in Profit and Loss Account, to Cashier's Checks, which was transferred or given to Mr. Skinner, to be held by him as trustee for the stockholders.

Q. The first paper explains, March 21, 1927, debit Profit and Loss Account, O. L. Price, 3/1, over-payment on stockholders assessment recorded to his account $7500, initialed by yourself and Mr. Skinner?

A. That is right.

Q. In connection with that March 2, 1927, debit Profit and Loss Account entry of 3/1/27, stockholders payment to guaranty fund, entered as stockholders assessment in error, held in "CC" meaning Cashier's Checks.

A. That is right.

Q. No. 172137, and so you will understand, Mr. Hart, Cashier's Check is No. 172167.

A. I can explain that.

Less O. L. Price over-payment refund $7500, and then a deduction from $929,600, that I read in. And the first group of papers

should be March 1st, to which this entry refers, showing debit on that slip of $922,100?

A. That is right.

Q. And then you say a Cashier's Check was made out. That is also initialed by you and Mr. Skinner?

A. Yes.

Q. Now the Cashier's Check referred to, that was given to Mr. Skinner, 172167 on March 2, 1927, $922,100 and signed by Mr. Hoyt and Mr. Skinner is still holding it?

A. Yes.

Q. As trustee for whom, you say?

A. For the stockholders who had paid in on this assessment.

Q. And is the subject of that entry?

A. Yes.

Q. And that is the way—your mind is sufficiently directed to this entry so you know what I am talking about—the way that was taken care of, as I asked you this morning?

A. Yes.

Q. And as auditor did you know—and to be certain if you did I will show you the book as of November 19, 1926, *what the amount of Sundry Bank items was on that date*, as shown on the daily statement of the bank.

Q. Did you know of that item?

A. I did.

Q. And at the time it was entered there?

A. Yes.

Q. And at that time it was what, as shown?

A. *The amount was $1,833,084.44.*

Q. And at that time your Cash Items was also shown to you, was it?

A. *It was.*

Q. How much?

A. $20,731.44." (r. 706, 707, 708)

Q. Can you tell me why, with respect to these papers you produced about this entry, that Mr. Skinner had to O. K. them, why he put his initials on them.

A. *Because he authorized me to make the entries.*" (715)

Price on the part of the defendants in salient features of his testimony pertinent to this summation testified among other things:

That the witness is a lawyer and was admitted to practice in 1900; that the first information he had of the total amount of the float transactions was during the criminal trial. He remembered a figure involving something like thirteen millions of dollars, during the period which was in question, but also recalled that there was a considerable amount of these transactions that were redeposited, and a very large amount of returned items, and also some that were paid. Mr. Morden went with him to the Clearing House and was there with him all the time of the first meeting, when he was explaining conditions and endeavoring to get help. That the rapid growth of the bank, the peak of the transactions, noticeably commenced in 1914 and ran up to 1918 or possibly 1919. Witness was

asked if he recalled along about May 25, 1926, before he went to Washington, that the assets objected to ran to an amount of three million and some odd thousand dollars, but stated that he did not recall the amount of assets that were objected to, he knew that in all the reports there were many items that were criticized, and when his attention was called to the Harris report of March 5, 1927, wherein Harris pointed out to him specific losses of $634,500.00, witness answered that the report would show that, but he had forgotten, that it was a considerable amount, but that he didn't remember the amount; that it was very likely, as overdue paper often amounts to considerable where people were getting renewals on it. His attention was then directed to the Harris report and the Wheeler lines outside the float, as far as estimated losses ran, $1,496,000.00 and some odd, and he was asked whether he recalled that amount outside the float of $800,000.00, and he stated that the total estimated losses were approximately two million dollars. The witness was asked if, when Harris got down to the place where he was computing the bank's total condemned assets or total criticized assets, he took a total of practically two and a half millions of money, and he answered "Practically." He was making—he was preparing for this 100% assessment which we requested. ***Witness was asked, "And you recall, don't you at that time, that Harris showed that Capital, Surplus and Undivided Profits, applied against what he computed,***

left the bank insolvent by several thousand dollars?" and he answered that Harris had made that provision.

That the first discussion of change in management was in the fall of 1922, but that was not taken up directly with the board of directors, that he discussed the matter with various members of the Board as to what might possibly be for the best interest of the bank, and this was following the time when some of the loans became slow and they had to cease paying dividends; that it was finally concluded that change in management was not necessary or advisable—that these matters were discussed with Mr. Charlton, Mr. Metschan and Mr. Spalding, he was not certain that he had talked to Spalding, but remembered discussing it with Charlton and Metschan. That in 1923 it came up again, but it was finally determined that Olmstead was the proper man for the place; he didn't recall having discussed it again until the meeting of June, 1926, the time with the Comptroller at Washington. That the loans he spoke of as affected by deflation were renewed from time to time, but continued down to the period of deflation and the Executive Committee thoroughly discussed these matters, and that the high peak in loans adequately secured was about $15,000,000.00. (r. 1060) When his attention was called to the published calls, say commencing in 1922, the witness answered that it must be remembered that

they were at their lowest at that time, because that was the deflation period that he spoke of, that the loans he spoke of were always carried in Loans and Discount, as the statements were made and amounted to the same thing he referred to when he spoke of Notes and Discounts. That all of their profits were charged up to take care of losses determined by the Examiner after they ceased to pay dividends in 1920; that the Executive Committee met every Tuesday and discussed loans and renewals, then passed their conclusions on to the Board, who passed on them, and they were recorded at their regular monthly meetings. The witness was not pleased with the sale of the Menefee and Standifer and Jones stock to Wheeler because he thought that that sale interfered with his negotiations to sell the bank. It did not occur to his mind as to the fact that there was engendered opposition between the element of the presidency of the bank, and the witness representing the Pittock Estate at that time. (1063) That he and Olmstead were always extremely good friends and as far as he knew that friendship still existed, but that his eyes had become entirely opened in the last few months—were apparently not at that time (1923) that he had every confidence in all the officers of the bank; *that he never figured at any time that he had control beyond the Pittock Estate, the Pittock heirs, handled by himself and Mr. Piper*— that that was the only stock he ever attempted to sell, *and didn't want any effort to make any sort of*

combination because he didn't think that was necessary, and he hadn't supposed any was being made against him. That Wheeler had had very extensive transactions with the bank prior to 1923, and that he knew generally the condition of affairs, that they were discussed often; that Olmstead had told him where Wheeler got the money to pay for the stock, at the same time that he told him of the purchase, that Wheeler had bought the stock and had borrowed the money from the Anglo bank with which to pay for it, and had paid the sellers cash. That between the years 1923 and up to the first Otto report in August, 1924, they were anxious to have the Wheeler obligations paid although at that time they thought they were perfectly good, but he never discussed the matter; that there were none of them that were anxious to loan Wheeler money in recent years; that the Wheeler loans were criticized by the Examining Committee in 1924, and the bank didn't want to lend him any more money, but wanted him to clean up his obligations, ***and it was at that time that Wheeler and his line were considered to be in charge of Mr. Olmstead, and that he Olmstead had handled it from the start and was continuously reporting what success he was having to the Board, and there were criticisms made of the Wheeler Loan in 1925; that most of the conversations they had were with Olmstead and not with Wheeler, as to the condition of the Wheeler loans, and they relied principally upon the reports which they got from Olmstead each week, although***

some of the directors may have talked directly to Mr. Wheeler—the witness did not recall that he had talked to Wheeler about it until after February, 1927, and when he talked to McIntosh in June, 1926, about the change in management, he had a copy of the last examination, the letter, before him and they asked just what he meant by that and he said of course he meant a change in the presidency; the witness did not recall that he said why, and could not recall any conversation with Metschan, or Stewart, that he had had as to why he recommended the dismissal of Olmstead, but presumed it to be because of the unsatisfactory showing that the bank had made in the last few years. Witness did not recall whether or not he had communicated to Olmstead what the Comptroller had said about the change in management, but of course Olmstead had seen the criticism. That it would have been somewhat embarrassing to him to have spoken about it, since it had been decided that it would not be wise to make a change as Olmstead was thought to be the person who could more readily get the subscription of $37.50 per share out of the stockholders, and to assist in working out the matter, getting the new corporation worked out; that they were anxious to have Wheeler pay up, and the Wheeler line was one of the objects of criticism as having been carried too long at that time. *That the letter of April 26, 1926, was the letter to which he referred, and as to what he meant as written by the Comptroller*, and that the witness

hesitated to speak about the matter, and did not recall any of the directors speaking to Olmstead about it, as they did not want to discourage him in putting his full heart in the work in regard to the corporation. Witness did not remember whether he wrote a letter or sent a telegram back to Washington stating that it would be all right for Mr. Olmstead to go ahead and see the stockholders.

AT THE REQUEST OF MR. HART IT WAS HERE STIPULATED THAT THE RECORD SHOULD SHOW THAT WHEN OLMSTEAD AND WHEELER WERE INDICTED BY THE FEDERAL GRAND JURY BECAUSE OF THE TRANSACTIONS OF THE RECEIPT AND GIVING IMMEDIATE CREDIT FOR A LARGE VOLUME OF McCORMICK LUMBER COMPANY CHECKS, WHICH CHECKS WERE RETURNED UNPAID, AND THAT BOTH OF THESE MEN WERE LATER TRIED AND CONVICTED ON THAT CHARGE IN THIS DISTRICT. (r. 1082)

SINCE WHICH TIME BOTH MEN ON MAY 15, 1929, WERE INCARCERATED FOR THE PERIOD OF THEIR RESPECTIVE SENTENCES IN McNEILL ISLAND AND ARE NOW SERVING TIME.

SPECIFICATIONS OF ERROR

(Rule 24 (b))

First Specification. The Court erred on the record in holding that these suits were not of a

local nature, and therefore erred in discharging defendant Chauncey McCormick, a director and resident of Illinois.

Second Specification. The decree of July 11, 1928, of the court below was and is erroneous in holding the said bills of complaint herein were without equity, that the allegations therein failed of establishment that the complainants were not entitled to relief as to any of the defendants and that the causes be dismissed.

Third Specification. That there was error in failing to hold and decide in conformity with the evidence and proof in said cases and upon the theory of the complainants' bills that the respondents were liable to the complainants as trustees, and that is such trustees they were liable for resulting injury for want of performance of their trust as the evidence showed it to be as directors of said bank.

Fourth Specification. That there was error under the evidence and record in this case in failing to hold and to decide that the defendants had mismanaged and did mismanage and had not conducted and did not conduct the business, assets and property of the Northwestern National Bank in the interest of the stockholders of said bank.

Fifth Specification. That there was error by the court below upon the whole cause in failing

and refusing to consider the evidence of the complainants and applying the same to the conclusion that the critical condition in which the bank came about to be in March, 1927 was due to the acts of said directors, respondents herein, and in failing to hold and to decide that they had reason and suspicion to know that the transactions which had withdrawn large amounts from the bank within the past year or so prior to its closing were plainly before the directors under the facts and circumstances which it was their duty to prevent.

Sixth Specification. That the action of the court below is erroneous in that it failed to give any consideration in conformity to the evidence of the transactions indulged in by the majority in control represented by said directors which subjected the stockholders and these complainants, appellants herein, to contingent liability as such as well as to an additional liability to the undertaking banks without the consent of such stockholders.

Seventh Specification. That under all of the evidence and the allegations of the bill the decree should have been for the complainants and against the defendants, respondents herein.

BRIEF OF THE ARGUMENT

(Rule 24 (c))

The arrangement of this argument is designed to follow the specifications of error in their order as made.

FIRST, *then, the discharge of McCormick.*

Where is the *situs* of the bank's assets and affairs? In the state and residence of the banking association or in the state and residence of the director?

Must the director who swears honestly and diligently to administer the affairs and assets of the bank at its place, be favored in event of loss to answer responsibility in the state of Illinois, at *his* place?

Are the equitable claims of stockholders of any less "LOCAL NATURE," or the accounting for dissipated assets of the bank of such situs, that the Court of the district where the bank is situated is without jurisdiction?

Then, if so, all bank directors need do is to reside in jurisdiction outside and away from the place of the bank to escape being called to account for their failures of duty and diligence in behalf of the bank.

Certainly the oath of office of all of these Directors applied to the doing the business of the bank at Portland, Oregon. Its assets, the equitable claims of the stockholders thereto, and the relations of the stockholders thereof were in no other place than here in the District of Oregon.

The defense succeeded in convincing the Court that McCormick could only be sued in the district of his residence, and disregarded the local nature of the whole matter.

No express case involving a bank director has ever been decided. By analogy, however, with respect to interests in personal property, there are cases in this district as well as others that support the position of appellants.

> *Consolidated Interstate Mining Co. v. Callahan*, 228 Fed. Rep. Page 531, *A decision by District Judge Dietrich.*

The assets of the bank and the means by which any accounting could be had were all in the District of Oregon, unless it is to be said that whatever liability came about in the accounting of the bank's affairs would be a personal liability of the director enforceable in Illinois. Well, that is a matter of enforcing the judgment of the District of Oregon as against property in another district for the purpose of getting satisfaction.

> *Chase v. Welzlar*, 225 U. S. 79, 56 L. Ed. 990.
>
> *Jellenick v. Huron Copper Mine Co.*, 177 U. S., Page 1, 44 L. Ed. 647.

The District Court of Oregon does not acquire jurisdiction in this case alone by diversity of citizenship but because the activities of this bank are

governed by federal law, and because the banking association is an instrumentality and fiscal agency of the United States, and it is and was with respect to its management that the court's jurisdiction was sought.

In *Dougherty v. McDowell*, 276 Fed. 728, it was held that shares of stock in a corporation have a *situs* as property in the state in which the corporation is organized, although the corporation has no other property there and transacts no business except to hold its annual meeting.

Myers v. Occidental Oil Corporation, 288 Fed. 997, and

France v. Buder, 11 Fed. (2d) 854.

are illustrations of the personal property rule and the local nature giving situs characteristics.

The Circuit Court of Appeals, Second Circuit, in *Norrie v. Lohman*, 16 Fed. (2d) 356, at page 358, distinctly held that the interests represented by shares of stock have a *situs* for the purposes of jurisdiction in the state where the corporation is engaged in business, and denominated the proceedings with respect to stock as *quasi in rem.*

Suppose McCormick has been sued in the Federal Court in Illinois by either of the complainants, in the interests of the bank and all other stockholders it can readily be seen that by virtue

of the nature of the proceeding itself (as it were stockholders upon their relation to the bank), McCormick could well say that the bank could not be a party against him in Illinois where he had not agreed to serve it, and that his duties were to be performed in Oregon.

If the jurisdiction is to be taken as a matter of personal privilege to the defendant, it follows that bank directors residing out of the district where a national banking association is located cannot be sued if the trial court is right. It may be said by analogy that if any receiver or agent of the Comptroller had sued for this bank the jurisdiction is specifically venued by statute in the District where the bank is. Naturally, not because of the statute, but of evidence.

SECOND, *then, Second and Seventh Specifications considered together.*

The decree of July 11 on which this appeal was taken, held the bills of complaint to be without equity, that there was no evidence to establish the allegations, and that the complainants were not entitled to any relief; and the appellants complain that under the evidence (summarized statement of which is shown in this brief), and the allegations of the bills of complaint, the appellants were entitled to consideration in equity and to an accounting and relief as prayed.

The pleadings so far as the two complaints are concerned do not differ except as to the ownership of the stock and the fact that one complainant alleges that offers were afterwards made for the Wheeler stock to get it into the combination on the basis of 10 cents or $10.00 per hundred. *The answers, however, are essentially peculiar.*

The court will find admissions of fact from each of the defendants, represented it is true by different counsel, but who seem to follow the draft of the pleadings prepared by Messrs. Carey & Kerr for the defendants they represented including the bank. Except for a difference or two upon the part of the defendant Spalding and upon the part of the defendant Morden, the wide differences and inconsistencies are found in the answers of the defendant Olmstead; and as he tells his story in his pleading it is entirely inconsistent with the stories of the other defendants. Substantially, too, Olmstead testified as he plead. The other defendants testified to conclusions and opinions or that "*they could not remember*," or "*could not recall*," but where any of them gave a fact it was in accord with Olmstead's pleadings and testimony, in all of the many particulars.

At great cost to the appellants all of the pleadings in both cases have been put in the record, though the cases were tried together as one case, substantially for all of the stockholders in behalf

of the bank. Obviously, because of the control of the stock by the Pittock Estate, Morden and Price, trustees, the bank itself as alleged was not or would not be authorized to sue them and their fellow directors. The evidence bears out Olmstead's pleading and supports the pleadings almost in every identical particular of both complainants. In fact, there is not one item that was alleged that did not have definite proof either in the examiners' reports introduced in evidence, or in the records of the bank introduced through the defendant Skinner. The explanations that the defense made about these transactions were as matter of course their interpretations of them under the law, but whatever interpretation is given to them it cannot be an interpretation that does not satisfy the law, and the duty required by law.

As set forth in the opening statement here in this brief the gist of this whole matter is inattention to and mismanagement of the affairs of the bank. What these directors were doing were not casual things, but deliberate assertions of activity of supervision in response to official complaint. And despite the disclaimers and denials of the defendants, it does not seem that anybody could do otherwise than attribute to them the knowledge which readily could have been obtained with respect to the financial condition of this bank in the course of the supervision which they professed to be actively exercising.

Please note in the letter of the directors dated October 23, 1925, addressed to Comptroller hereinbefore set forth, and the reply of the Comptroller under date of November 17, 1925 thereto, followed by the communication to the same Directors by the letter of the Comptroller of Currency, dated the 26th day of April, 1926 (set out herein in the summary of the evidence for the information of the Court) it distinctly and unequivocally appears that the very things that were to be done were pointed out to them by the officials of the United States. These are the very acts of failure and omission that received condemnation by the Supreme Court *in the Yates case*, 240 U. S., Page 562.

Moreover, these directors appointed a Committee in May to go and see the Comptroller in June, 1926. Olmstead could not go on account of the sickness of his wife, so Price, Metschan and Stewart went, and the whole summer of 1926 went by.

Now comes the astonishing aspect and position of these directors, that is, that the report of Harris based on the examination September 21, 1926 was to help them to get a company organized to take over the undesirable non-bankable assets. Here is what the national bank examiner said in his letter (hereinbefore quoted in the summarized report of the evidence for the aid of the Court), on the 27th of October, 1926, to Olmstead:

> "Estimated losses impair your capital in the sum of $237,460.78, the only legal means for the restoration of which is an assessment. WHICH WOULD NOT ONLY CAUSE UNFAVORABLE COMMENT BUT WOULD LEAVE THE BANK WITHOUT A SURPLUS FUND."

It does not look likely or reasonable that the purpose the respondents assigned to this report can be interpreted consistent with this language.

At this particular time there was over four million of doubtful assets and losses, and the examiner went on to say that it was entirely inadequate to do otherwise than to remove all of these possible losses and doubtful assets so that the bank might take its proper place among metropolitan institutions. If the reasons assigned by the defendants is as they endeavored to make the Trial Court believe, *why did the Comptroller* on December 2, 1926 write the Board of Directors referring to the Harris report of September 21, 1926 *and call attention to the impairment of capital surplus and undivided profits?*

During this very time there is an entire want of record entry to show that the Board of Directors considered the Examining Committee's report or acted upon it until February 16, 1927. That is the Examining Committee's report in November, 1926.

But the Board of Directors on the 11th day of

December, 1926, holds a meeting considering the Harris report, recognizes the comment and criticism, and says they were given special attention and adopts the suggestion to organize a company to take out non-bankable assets.

It is perfectly plain from the evidence hereinbefore quoted, particularly of that of Skinner and the report of Examiner Wilde of March 25, 1926, that the Board of Directors had before them the entire matters referred to in the respective bills of complaint as therein alleged, and which are shown in the Wilde Report in the quotations hereinbefore made (Pages ... to ...) and they were told that the bank had been doing an illegitimate business, the words used were "*Beyond its legitimate field of banking,*" and wound up with the statement that "*these transactions were investments which your Examiner considers as entirely outside of the purpose for which banks are chartered.*" This was written March 25, 1926, and became and was the foundation of the letter from the Comptroller of Currency to the Directors on April 26, 1926; so there is no doubt of knowledge, notice and full information.

How, then, can it rightfully or justly be said that there was no evidence to support the allegations of the complaint, that there was nothing upon which equity could exercise its functions?

Judge Robert Sharp Bean, the trial judge in the

criminal case against Olmstead and Wheeler was the trial judge in this case; and in the criminal case he delivered the law principles as follows:

> "Now under the law of the United States a given number of persons may, by complying therewith, obtain a charter or authority to set up, open and operate a federal reserve bank. The association so organized and formed becomes a corporation with an entity and a legal individuality separate and distinct from its officers and stockholders. It is important, I think, in a trial of a case of this character, to keep that fact in mind, ***and to remember that the officers of a federal reserve bank are not the bank, but simply its agents,*** authorized and empowered to supervise, and manage and control its affairs. After a bank has been organized and authorized to do business, it may receive deposits, keep the accounts of its customers, pay checks, make loans, discount bills, issue drafts, and in fact do a general banking business. It is apparent therefore that the interest of the depositors in a bank, ***and of the stockholders*** and customers depend largely upon the integrity and financial standing of the institution, ***and as its officers and those in control thereof,*** and charged with the conduct of its affairs, ***may through carelessness, recklessness or violation of the law, dissipate and waste the funds,*** the law has provided certain penalties and certain provisions to prevent matters of that kind. The law does not require or compel any person to become an officer or employe of a federal reserve bank. No one is compelled by law to discharge any of the duties which it prescribes, or to place himself in a position where it is possible for him to commit any of

the crimes denounced by the statute. ***If, however, he voluntarily becomes an officer of the bank, the law requires of him the faithful and honest and exact performance of his duties.*** And in order to accomplish this, it has provided, among other things, that any officer, director, agent or employe of any federal reserve bank who wilfully misapplies the moneys, funds or credits of the bank, with intent to injure or defraud the bank, and every person who, with like intent, aids and abets him in so doing, shall be guilty of a crime, and if convicted shall be punished as in the statute provided."

Record (*U. S. v. Olmstead and Wheeler*)
Volume 6, pages 1632 and 1633.

"Before the law all persons stand on the same footing. It is the duty of courts and juries to administer the law without respect to persons and do equal justice to all without regard to rank and standing."

Record (*U. S. v. Olmstead and Wheeler*)
Volume 6, page 1651.

THIRD, *then, the Third, Fourth, Fifth and Sixth Specifications considered together.*

So arranged to avoid duplication of argument and presentation of authority.

The record, at this point, presents to us a bank that had been continuously reported to the Comptroller and to the public as in excellent and unusual condition, and of rapid and continuous growth, upbuilding and progress.

The record also shows that as early as March, 1926 the account of McCormick Lumber Company was opened and the check transactions almost immediately reached large volume by May of that year, and in June and July, Hoyt and Bates and Longshore and Brown knew and called the attention of their superior officers to as much as $200,000.00 of these checks floating around.

The record also significantly showed that in the Wilde report of March 25, 1926, this same practice as outlined by Skinner in language as follows, was called to the attention of the directors:

> "*Sundry drafts in transit* discounted by J. E. Wheeler are drawn by J. E. Wheeler upon Wheeler and Wheeler Lumber Company at San Francisco, and Schmearbaugh, Pennsylvania, and are carried in account "*Bills in Transit*" and should be carried in "Loans and Discounts," and that one of these drafts was a renewal and that the *McCormick Lumber Company protested checks and Wheeler-Olmstead Company protested checks, both carried as Cash items*, were eliminated during the examination, having been taken up by J. E. Wheeler and McCormick Lumber Company. (PLEASE NOTE) (our words).
>
> "The original checks were payable to and credited to the account of J. E. Wheeler, and at this examination classed as 'Excess Loan' with direct liability to J. E. Wheeler."

The examiner furthermore tells the Board that this entire Wheeler loan was the elimination of

the McCormick indebtedness at that time of some $87,000 *but the addition to the loan of the Discount and Cash Items listed above.*

Then in the face of this we have the visit to the Comptroller at Washington by three of the Directors obviously to see what was to be or could be done. That was in June, 1926, by Price, Stewart and Metschan.

All of the Wheeler transactions were in the bank, and a large number of other items too numerous to mention, and the Examining Committee was examining, and FRALEY says in detail in the evidence hereinbefore quoted what he told them to do, and called their specific attention to the very things that the complainants in this case alleged about in their complaints. And yet Mr. Skinner, Mr. Stewart, Mr. Price, Mr. Collins, Mr. Metschan and Mr. Spaulding, say they knew nothing about it. IT WAS THEIR BOUNDEN DUTY TO KNOW.

In this state of affairs let us pass the discovery of the float as it is stated to be by them February 11, and we come to the dismissal of Olmstead and the institution of Price, with the same directors, and we are told that O. L. Price has been elected president of the bank and will have active charge of the bank's business, and it will continue to serve the public *as a financial institution of first importance and known responsibility.* This was March 2, 1927, and in 27 days the bank closed its doors.

The first part of this statement of March 2nd, 1927, is in accordance with the allegations of the bills of complaint that the Pittock Estate had acquired a large measure of interest and control in the bank corporation. *Three days after* this publication which was given out by the officers and directors of the Northwestern National Bank as the proofs show, *Harris made his famous report of March* 5, 1927, *and the directors wrote the letter of March* 18, 1927 *to the Comptroller of the Currency hereinbefore set out.* Space does not permit of its being set out again, but a reference to it discloses that no correction had been made of the previous impairment of capital surplus and profits.

Do not let us forget that this had previously been called to the Board's attention in September, 1926, that the Board knew by the Wilde report in the early spring of 1926 a similar state of affairs. Do not let us forget that as early as the 28th of July, 1924, Mr. McIntosh himself wrote to these Directors the letter hereinbefore set forth, showing the same situation of the figures applied to the impairment of capital, surplus and profits of this bank; and yet the directors were reporting it in sound condition and of known responsibility and continued subjecting the stockholders to that imputation of care and attention and responsibility to the public which of course as directors they were bound to protect.

But "LEST WE FORGET," each and every one of these defendants who testified SAY THE WHEELER MATTER WAS LEFT TO OLMSTEAD.

The By-laws of their own institution prohibited that; and Price was Chairman of the Board when Olmstead was President. The directors admit in their letter of March 18, 1927, that the bank had been *under criticism* from Washington *for a number of years*, and in this letter notwithstanding the publication of March 28, 1927 in the Oregonian, they were unanimous in the request that the Comptroller issue a formal notice of impairment of capital. They admit in their letter that they had no fault to find with the classification of assets made by the Examiner. When the Examiner, however, made a suggestion about notes, they very readily stated why they did not desire to give notes as directors.

Nevertheless, their attention was called that losses had been estimated on loans classed as excessive, and that the directors had been requested to remove these notes personally (PLEASE NOTE THAT).

They discussed the law with the Comptroller and make the aspiring statement "WE DO NOT ADMIT ANY LIABILITY IN THIS CONNECTION." Well, they may not admit it, but at that time, the law said the liability existed, and officials of the

United States charged them with it,—how could the Trial Court ignore such evidence? Then they followed this in this letter with this statement, *"While there are excessive loans in the bank, and at least one of these loans became excessive in direct violation of the resolution of the Board,"*

If Your Honors please, this famous resolution of the board insiduously referred to, was that of October 9, 1924, when Olmstead was away, and there is no evidence that they ever did otherwise than continue the same activity by the same loaning officers that they always had. Then this letter denies that they wished to avoid comments incident to an assessment, and the advertisement and sale of delinquent stockholders. Then comes this second remark, *"Some months ago you suggested that we consider a change in the management and a change recently occurred, by the resignation of one of our active officers whom we believe to be the one referred to in your letter."*

OPENLY FRANK, WASN'T IT?

The testimony of Mr. Price on this subject is very enlightening (Pages ... to ... in this brief). This letter of April 18 was signed by all of the then directors except Olmstead and McCormick.

But the astonishing thing about this whole matter is that for weeks previous and commencing as early as 1923 the Pittock people were attempting to sell the bank, and Price and officers of the bank

had been negotiating in January and February, 1927, with the First National and United States National Bank, respectively, of Portland for a disposition of the Northwestern National Bank. Indeed, prior to the time that Price became president. Everyone knew of the failures of these negotiations, and yet they advertised to the public and made statements as late as March 23rd of the unimpaired condition of this bank. Please note, Your Honors, that the published statement of March 23rd was five days after this letter they wrote of March 18th, wherein they admit impairment of capital, undivided profits and surplus and discuss a way to avoid it, and yet include that very capital, surplus and profits unimpaired in the statement published March 28. The next day the bank closes; and Mr. Ainsworth and Mr. Fraley said with a $7,000,000.00 shortage.

It needs little further comment on the facts to address ourselves to the law; but let it be presented in conclusion, with respect, that on the 29th of March as hereinbefore set out, (*and exactly what they did as set forth in previous pages of this brief in the summarized evidence*), these directors made and passed resolutions which speak for themselves, and put it in the power of Price and Morden for themselves and accompanying directors for the entire disposition of this bank, and then turned it over under the proposal therein made which consisted of the contract of March 29, 1927, without

any proceeding required by law to obtain the single assent at that time of any stockholder whomsoever, save those of course who could be said as the result of being directors to be stockholders; and as to them no step required by law.

But the point is that the law says that it is the stockholders who shall say what shall be done with an institution of this kind in that situation; AND NOT THE DIRECTORS.

The evidence shows that there was no resort to a deliberative assembly of the stockholders or any advice or information to them given prior to March 29, 1927, on which day the special meeting of the directors was held and no notice whatever was purported to be given until March 31, 1927, when the damage, injury and harm had then been done.

And the evidence shows that the directors were wholly without power and authority to make a new and independent relationship or contract a liability for non-assenting stockholders, although they had previously made combined and confederated among themselves upon an arrangement and agreement to escape their own liabilities if possible by abdicating their powers of management of the business as it then existed to the other banks and afterwards go into liquidation, and they were advised in the start that other non-assenting stockholders objected to this, to-wit: Cotton and Griffith, and as soon as these complainants were advised and knew

it they also dissented, for it is apparent from the evidence that the larger interest acquired by the Pittock estate as advertised March 2, 1927, consisted of the deposit of $929,600.00 which was calculated to remove and take up and therefore became the money of the bank when they did take it up, to-wit, the alleged Wheeler float, apparent from the statement book of February 28th and March 1st resolved into the entry of March 2, 1927.

Between February 28th and the 3rd day of March these entries were made under the direction of Mark Skinner, one of the vice presidents, with the recorded participation of the very individuals who are defendants herein in sundry amounts either then or afterwards to be made of the items designated as the Wheeler float, and it is obvious that the payment or contribution of the same is an admission of liability therefor.

The much talked of war commenced in 1914. But there was not a war loan transaction in taking over Merchants National Bank acquired October, 1915.

Sensenich says most of loans 1918 to 1920 and all prior to March, 1923. Hart says the complaint items were war loans accumulated in the war period. In July, 1922, however, the increases of capital stock were made and the bank published with the knowledge of the directors in the Oregonian, July 2, 1922, to-wit:

"It was during the war period from 1914 to 1918 that the Northwestern National Bank's growth was most rapid. In that four year period it led all of the country in percentage of growth."

"It has attained a place among the strongest capitalized banks in the Northwest."

Now this capital (see Burckhardt correspondence) was taken by some and not others and amounted to 10,000 shares at $150.00 per share or $1,500,000.00, which comprised according to answer of defendant Spaulding voluntary contribution of $500,000.00, of which $35,000.00 he says went to *"earnings account"* and $150,000.00 to surplus, thereby increasing surplus to $400,000.00 from $250,000.00 surplus theretofore carried, yet the record is that $389,000.00 was then charged off. These loans then must have been renewed and extended lest they would outlaw within the five year real estate carry permitted when that character or within six years for want of payment—hence each successive board knew this and acted accordingly clear into March, 1927.

That during all the times from the increase of stock in July, 1922, each and every officer and director of this bank knew that often banks carry as cash "CASH ITEMS" items on which cash has been paid out but for some reason the items have not been charged to the accounts against which they were drawn, and it was their duty to carefully examine these cash items, for it was known in 1924

that similar items had been carried and they made a notation of their refusal to advance credit deliberately on October 9, 1924, as shown by their own record and that various checks, notes or other items were then deemed by them to be irregular and they knew it to be the duty of the examining committee and of themselves that stale or irregular items should not be carried and they knew and had cause to know that lists of all uncurrent or irregular items had been around the bank and it was their duty to make them up, especially those that would not be cleared out in the following day's business, and it was also their duty to see that there was prepared a record of all such items and satisfactory explanation given concerning each one, but instead of doing so they leave everything to Olmstead, although the by-laws otherwise provide and although Price knew, Skinner knew and Stewart knew and all the junior officers in the bank did know, as well as the clerks having the matter in hand, what was going on, and nevertheless they wholly ignored and failed to use diligence in acquiring such knowledge of the business as was open to them and they therefore cannot now be heard when sued to say they were not apprised of facts the existence of which are shown by the books, accounts and correspondence of the bank open and observable to all of them, and it was a breach of their duty to the stockholders in each and every instance in the course of the conduct of said bank to allow said things to happen.

The claimed effect of the deflation period disregards the revival period in the six years thereafter.

On the authority of Irving Fisher, Economic Professor of Yale (N. A. R. Vol. 228 No. 1, p. 74) we find this said of the recovery period:

> "Thus the years of post war recovery, especially after the deflation of 1921, have witnessed the largest increments of real income of any like period in our industrial history. Production has augmented, real wages have increased, great mergers have reflected the opportunities of mass production, etc."

According to the National Bureau of Economic Research American income in 1921 was nearly 63 billion dollars. It rose to 90 billions in 1926, and is constantly going higher.

Judicial information and judicial knowledge will not disregard these plain facts.

Listed and carried as cash may be found "Exchanges for Clearing House," "Checks on other banks in the same city or town," and "Checks and drafts on banks located outside of the city or town." These items should be separated from and not confused with "cash items," for they are current items which will be cleared in the course of business on the following day. These items should be listed and compared with the totals shown on

the "Cash Book," to see that they are carried for the correct amounts." (Major on "Duties of Directors, etc., p. 117.)

The readiest means you have of finding out what becomes of the funds of a bank is by studying the statements published periodically by the bank. Every dollar of assets and liabilities is set down there and if you know what the figures mean you can form a clear judgment of the actual condition of the institution.

> "Often banks carry as cash, 'cash items,' items on which cash has been paid out, but for some reason the items have not been charged to the accounts against which they are drawn. The cash items should be carefully examined by the Committee. It is sometimes found that the officers of the bank are carrying as cash items various checks, notes or other items which are irregular. The Committee should see that no 'stale or irregular' items are being carried. A list of all uncurrent or irregular items, those that will not be cleared out in the following day's business, should be prepared and a satisfactory explanation should be had concerning each such item." (Major on "Duties of Directors, etc." p. 117.)

That while knowing and having cause to inquire for further knowledge they allowed "cash items" of more than $200,000.00 in July, 1926, as fictitious credits in the transactions of said bank, to which the attention of Price was then specifically drawn, to grow and increase through August and the rest

of the summer and fall of 1926 until Skinner's previous as well as his specific attention on February 10, 1927, was directly called to about and over $800,000.00 of such cash items outstanding, although significantly the examining committee makes no record or any comment to the bank or officials when it met May 18, 1926, nor indeed when it presented its report of December 7, 1926, to the directors on February 16, 1927, at which time Skinner knew, Price knew, and every other director and officer had the opportunity to know, *and all the junior officers in the bank did know*, that *"sundry banks account"* was carrying increasing amounts of transit items sufficient to excite any one's attention and *"cash items"* and *"bills in transit"* continually and daily increased as these three (3) records or accounts so named were exhibited on the daily statement record of said bank during and from May and June, 1926, to and inclusive of March 2, 1927, all the time as such daily record was so made every day to be placed before and seen by the directors and officers of said bank in a convenient place on Brown's or Jones' desk in the officers' quarters of said bank, where it and all thereof was easy of examination, inquiry, notice and knowledge during all said times, but the said directors utterly failed to act thereon or do anything in wilful violation of their duty to watch over and guard the interests committed to them and in violation of their respective oaths of office and the obligations they each thereby assumed and to the prejudice

and destruction of the interests of stockholders of said bank and the bank itself.

The defendants participated in or assented to so conducting the bank's affairs knowingly to maintain a fictitious valuation upon the capital stock of the bank affecting these complainants and all other stockholders.

That these defendants knew and knowingly brought about and into the published reports and records of the bank the totals of the very loans in the total of maintained loans and discounts at said times as criticised and condemned as the objectionable paper by the examiners in turn and by the Comptroller in particular, and knew and willingly permitted these to be part and become elements shown in the published and included with the records and reports of the bank and consequently at the time of official calls that such reports Dec. 31, 1924; Sept. 28, 1925, Dec. 31, 1925, April 12, 1926; June 30, 1926; Dec. 31, 1926 and March 23, 1927, were wholly incorrect and therefore did not truthfully reflect or inform stockholders or the public of the true and actual condition of said bank and these acts are violations of law, both actually and constructively.

Under the by-laws of this bank as shown in evidence the chairman of the board and the board of directors and not the president were the authorized heads of the bank and the evidence shows that

a change in management was suggested as far back as 1922 or prior to March 10, 1923, and it was suggested again and finally confirmed by the board of directors to the Comptroller and yet it is said that in the indulgence and carelessness which is exhibited by the testimony in this case in the various transactions the matters were left to Olmstead and he who does a thing through another does it himself. Any indulgence or carelessness whatever well exhibited by the condemnatory resolution of October 9, 1924, show knowledge of what was going on and the transactions of 1926, daily occurring importing knowledge of what was going on. A knowledge which was readily acquired, demonstrated that some effort had to be made to say that those in charge of the affairs of the institution would keep within the statutes and the by-laws which control. The evidence shows that the directors and committee failed, as well as the chairman of the board, to bring about the proper administration of the bank's affairs in these particulars. The evidence shows that all these directors participated in and approved a long continued carrying on the books among the loans and discounts of a line or lines which they knew to be worthless and required to be retired in amount sufficient materially to affect the standing of the bank. In this position they were bound to know and act that under the practice such worthless paper would become as the practice was prevailing in said bank an element of its published reports

and that these reports would not reflect the true condition of the bank, and each and every one of said directors while in this position and allowing said reports to be published and permitting the making of the same were guilty of misconduct amounting to violation of law and their failure to act does not excuse them.

Beyond these specific matters there was made at the trial specifications of inattention and mismanagement in several enumerated particulars deemed to be fully established and proved by the evidence; but the trial court disregarded them, as follows:

In not seeing what was open, visible and notorious to be seen in and about and upon the records of said bank.

In not acting promptly upon what was, or to be, seen and known and thereby to be known in the records of said bank so that said bank might have and obtain prompt and vigorous management, direction, supervision and activity in regard thereto.

In not forcing Wheeler's liquidation in sale of his publishing business, or other properties, and call his then loans, that the burden of his indebtedness to said bank as then were known might be relieved.

In waiting and delaying action on matters of importance until emergency was thereby created—(a) in conditioning assets of the bank; (b) by the increase of Wheeler's indebtedness and financial embarrassment; (c) by failing to deal for the sale of the paper on frequent proffered occasions, of Telegram Publishing Company, and until that company went broke.

In dallying over a period of years with Comptroller and failing with promptitude to clean up the matters of financial entanglements which finally overtook them, and each of which were by said Comptroller called to their attention in writing.

In surrendering to Price the management of the Bank in a very critical period of its career.

In putting in the position of president of the Bank Price, as manager of the "Oregonian," and trustee of the Pittock Estate. (See announcement March 2, 1927.)

In failing to allay and remove interior dissension and sustain coordinate effort within the Bank for if change of management in presidency was intimated or suggested as early as they say and as early as the year 1923 as the evidence shows, then it was negligence to wait until March 2, 1927, with the progressive and increasing embarrassment of the bank's affairs, before they effected the change, and in so doing then attract to said bank want of

confidence and impairment of position in the mind of the public.

In bringing about an entire change of management in bank policy by the Pittock Estate and the induction of Price, whose previous dealings with directors' knowledge with the competitive banks had already disclosed to the public the weaknesses of the institution.

By so acting and doing as to destroy the confidence and thereby impair the belief of the public in the soundness of the institution and the correctness of published bank assets of alleged known responsibility and solvency as in said reports set forth.

In knowingly creating and permitting an emergency to come about and develop in the affairs of the bank through their own acts, or by acts which could have been prevented in the ordinary exercise of business judgment, whereby Price was allowed to negotiate the private and confidential business of said bank to and with the United States National Bank and the First National Bank, of Portland, Oregon.

In knowingly and willingly permitting non-included stockholders in the deal they did make to be and become liable for these several derelictions of them, the said respondents, by (a) charging liability over by virtue of statute; and (b) charging

liability over by virtue of contract, to the First and United States National Banks, March 29, 1927, without first taking any deliberative vote, determination or consideration whatever of the whole body of stockholders in said bank.

By knowingly and willingly bringing about liquidation at their own initiative without first taking the deliberative determination, consideration and vote of all of the stockholders on that subject.

If the Court believes the evidence of Ainsworth and Dick then the impairment was an accomplished fact when the negotiations were first on with the two other banks in February, and the witness Stewart agrees with Dick that cash items treated as this bank treated them required greater reserve cash in Federal Reserve Bank.

By making and renewing excessive loans, and knowingly and willingly permitting them so to be made, against sound business policy and against the law and thus subjecting the bank and its stockholders to unnecessary danger of collapse of the bank.

By making incorrect reports to the Comptroller and purposely keeping the stockholders ignorant of the true condition of the bank whereby many of them were induced to hold on to their stock until it became valueless.

In disclosing the private and confidential affairs of the bank to its competitive banks, U. S. National and First National and in entering into negotiations for the sale of the bank with said competetive banks without knowledge or acquiescence upon the part of the stockholders under the circumstances in February and March, 1927, impairing the said bank; and its then condition was permitted by said directors having then cause and occasion to know that the state of the bank's then impaired condition and affairs would become known and subject all stockholders' interests to ultimate loss and disaster.

Independently of statute, one in control of a majority of the stock and of the board of directors of a corporation occupies a fiduciary relation towards the minority stockholders, and is charged with the duty of exercising a high degree of good faith, care, and diligence for the protection of their interests, and every act in his own interest to the detriment of the holders of minority stock is a breach of duty and of trust, which entitles a minority stockholder to plenary relief in equity.

The rule is fundamental that one in control of a majority of the stock and of the board of directors of a corporation occupies a fiduciary relation towards the minority stockholders, and is charged with the duty of exercising a high degree of good faith, care and diligence for the protection of such minor-

ity interests. Every act in its own interest to the detriment of the holders of minority stock becomes a breach of duty and of trust, and entitles to plenary relief from a court of equity.

> *Jackson v. Ludeling,* 88 U. S. (21 Wall) 616, 624, 625, 22 L. Ed. 492;
>
> *Jones v. Electric Co.* (C. C. A. 8), 144 Fed. at page 771, 75 C. C. A. 631;
>
> *Wheeler v. Abilene, etc., Bldg. Co.* (C. C. A. 8), 159 Fed. 391, 394, 395, 89 C. C. A. 477, 16 L. R. A. (N. S.) 892, 14 Ann Cas. 917;
>
> 3 Clark & Marshall on Corporations at page 2289.

Where a board of directors, or a majority of them, are acting for their own interests in a manner destructive of the corporation itself or of the rights of the other shareholders.

> *Hawes v. Oakland,* 104 U. S. 450, 460, 26 L. Ed. 827.
>
> *Corbus v. Gold Mining Co.,* 187 U. S. 455, 463, 23 Sup. Ct. 157, 47 L. Ed. 256;
>
> *Gamble v. Queens County Water Co.,* 123 N. Y. 91, 99, 25 N. E. 201, 9 L. R. A. 527.

Such latter action is a breach of fiduciary relation. Breach of duty and abuse of fiduciary obligation do not necessarily involve "intentional moral delinquency." If the act amounts to what the law considers a breach of trust, a disregard of duty, it is sufficient.

Dodge v. Woolsey, 18 How. 331, 345, 15 L. Ed. 401.

See *Pollock v. Farmers' Loan & Trust Co.*, 157 U. S. 429, 553, 15 Sup. Ct. 673, 39 L. Ed. 759.

A breach of trust by one occupying a fiduciary relation, even while in the exercise of a lawful power "is as fatal in equity to the resultant act or contract as the absence of the power."

Jones v. Electric Co. (C. C. A. 8) 144 Fed. 765, 771, 75 C. C. A. 631;
3 Clark & Marshall on Corporations, p. 2289.

Hyams v. Calumet & Hecla Mining Co., 221 Fed 529, at page 529, 537 and 543.

"THE FRAUD OR BREACH OF TRUST OF ONE WHO OCCUPIES A FIDUCIARY RELATION WHILE IN THE EXERCISE OF A LAWFUL POWER IS AS FATAL IN EQUITY TO THE RESULTANT ACT OR CONTRACT AS THE ABSENCE OF THE POWER. THE RELATION OF A STOCKHOLDER TO HIS CORPORATION, TO ITS OFFICERS AND TO HIS CO-STOCKHOLDERS IS A RELATION OF TRUST AND CONFIDENCE."

Jones v. Missouri-Edison Electric Co., (C. C. A. 8th C.), 199 Fed. 66.

"Such a majority of the holders of stock owe to the minority the duty to exercise good faith, care, and diligence **TO MAKE THE PROPERTY OF THE CORPORATION IN THEIR CHARGE PRODUCE THE LARGEST POSSIBLE AMOUNT, TO PROTECT THE IN-**

TERESTS OF THE HOLDERS OF THE MINORITY OF THE STOCK, AND TO SECURE AND DELIVER TO THEM THEIR JUST PROPORTION OF THE INCOME AND OF THE PROCEEDS OF THE PROPERTY."

Jones v. Missouri-Edison Electric Co., (C. C. A. 8th C.), 199 Fed. 66.

Affirmed, 203 Fed. 946.

"Whether the directors of a bank be called agents, trustees, or quasi trustees is of little importance. Whatever their designation, their relation to the bank and to all of its stockholders, both minority and majority is fiduciary in character and one of confidence and trust.

"It was the duty of the directors of the Marquette National Bank actively to protect and to preserve the property placed in their hands by the stockholders.

"In this case the managers of the business were either the agents or the trustees of the bank and its stockholders, and everything of value resulting from their services and efforts as such agents or trustees belonged, not to them individually, but to their principals or cestuis que trustent, the bank and its owners."

Kaufman v. Marquette Nat. Bank, 289 Fed. 299.

The directors are the trustees for the stockholders and also for the corporation and the corporation itself is the agent and trustee of its stockholders and it cannot be denied that it is the right of every one to see that his property is well managed. The stockholders are the

owners of the assets and have an interest in the assets and business and a right to be informed of the financial condition and of the property itself.

Guthrie v. Harkness, 199 U. S. 154, pages 154 and 155, 50 L. Ed. 132.

The corporation is nothing but the hand or tool of the stockholders, in which they hold its property for their benefit. They are the equitable and beneficial owners and holders of all its property and the corporation is the mere holder and manager of it for them.

The position that a stockholder in a corporation has no interest in the enhanced value of its property, or in its undivided income, profits and surplus is untenable and may not prevail.

Lynch v. Turrish, (C. C. A. 8th C.) 236 Fed. 656.

"Sec. 4119. CORPORATION MAY SUE ITS DIRECTORS, either at LAW OR IN EQUITY.—It is scarcely necessary to suggest that a suit for the purpose of setting aside transactions of the directors or their governing body, in fraud of the rights of the corporation, may be brought by the corporation itself. There is no possible doubt, either in England or in this country, of the right of a corporation to maintain such an action. Indeed, actions at law are constantly maintained by corporations against their unfaithful directors, where the facts are appropriate for redress at law; *and in equity the question most frequently arises is, not whether the corporation may bring such an action*, but whether it is not the only party which can bring it. Where the

ground of action is misfeasance or culpable negligence, the corporation, not the stockholders, is a proper party plaintiff,—though, under some remedial systems, the stockholders, and often a creditor, may maintain an action at law; and *where the corporation is still under the control of the unfaithful directors, so that redress of the grievance cannot be had by an action in its name, a stockholder may maintain a proceeding in equity, suing for himself and all other stockholders, to protect the rights of the corporation, as trustee for its stockholders and creditors.* Actions brought by stockholders under this theory involve the rights of minority stockholders, as well as the rights of the corporation; and the questions arising in such actions are so numerous and complicated that it has been thought best to deal with them in a separate title.

(*Ryan v. Leavenworth, etc. R. Co.*, 21 Kan. 365; *Denny v. Manhattan Co.*, 2 Denio (N. Y.) 115; *Cross v. Sackett*, 16 How. Pr. (N. Y.) 62.)

(*Simons v. Volcan Oil & Mining Co.*, 61 Pa. St., 202; s. c. 100 Am. Dec. 628; *Branch Bank v. Collins*, 7 Ala. 95; *Franklin Fire Ins. Co. v. Jenkins*, 3 Wend. (N. Y.) 130.

(Post, Sec. 4471, et seq.)"

3 Thomp. Corp Sec. 4119, p. 3017.

"* * * The author conceives the rule to be capable of a wider statement, thus: If the directors of a corporation are guilty of a breach of trust, injurious to the corporate property, or to the rights of the shareholders, or a portion of them, and if the corporation refuses to institute the proper proceeding to restrain, or redress such injury, one or more of the share-

holders may do it in their individual names. This definition, it is perceived, extends the right of action to the redress of breaches of trust injurious to PARTICULAR SHAREHOLDERS, as well as those which are injurious to the corporation, that is, to ALL THE SHAREHOLDERS. IT PROCEEDS UPON THE THEORY THAT THE DIRECTORS ARE NOT ONLY TRUSTEES FOR ALL THE SHAREHOLDERS, BUT IN A LIMITED SENSE, FOR EACH OF THEM. For while it is the law that wrongs by directors are more properly redressed by a suit in the name of the corporation, and while in technical and artificial theory, the directors are primarily the TRUSTEES OF THE CORPORATION.—yet, as in point of substance and sense, the corporation consists of the aggregate body of its shareholders, it is obvious that, in the most substantial sense, the directors are TRUSTEES FOR THE SHAREHOLDERS, and that in any action to redress breaches of trust on the part of the directors, the SHAREHOLDERS ARE THE REAL PARTIES IN INTEREST."

4 Thompson on Corporations, Section 4479, Page 3306-7.

"The question rather is whether they were guilty of neglect in not knowing or ascertaining these things and in not taking steps to prevent or remedy them—such culpable neglect as would make them liable under the general principles of the common law governing the duties of the bank directors which apply to national banks as well as all other banks."

Rankin v. Cooper et al. (C. C., W. D. Ark. E. D.) 149 Fed. 1012.

"If, upon the other hand, directors know, or by the exercise of ordinary care, should have known, any facts which would awaken suspicion and put a prudent man on his guard, then a degree of care commensurate with the evil to be avoided is required, and a want of that care makes them responsible."

Rankin v. Cooper et al. (C. C., W. D. Ark. E. D.) 149 Fed. 1013.

"It seems to me, however, that the only effect that should be given to the by-law is to treat it as a piece of evidence in the nature of an admission on the part of the directors as to what they regarded they were called upon to do in the performance of their duties in examining the bank. If the directors were not chargeable with knowledge of what the by-law called for, it seems to me that the fair inference is that they knew what it called for, inasmuch as they understood they were to make examinations twice a year. Under the by-law, they were required:

"To examine into the affairs of the bank, to count its cash, and compare its assets and liabilities with the balances on the general ledger, for the purpose of ascertaining whether or not the books are correctly kept, and the condition of the bank in a sound and solvent condition."

And, irrespective of the by-law, I find that due care on their part required them, in examining the bank, *to compare the liabilities, as they appeared on the depositors' ledger at the time the examinations were made, with the cashier's ledger.* The master finds, and the finding is not questioned, that they never looked at the depositors' ledger, which was the

book upon which the chief liability of the bank was kept, and consequently never compared the liability as there shown with the balance due depositors on the cashier's ledger for the purpose of ascertaining whether or not the books were correctly kept."

Bates v. Dresser, et al. (D. C., D. Mass.) 229 Fed. 787.

"The ground upon which these cases seem to proceed is that the directors of a national bank, in entering upon their duties as such officers, impliedly agree to properly and faithfully perform them, and if by misconduct or negligence they fail in this respect, and damage ensues, a cause of action arises which the receiver may enforce for the benefit of the stockholders and creditors: that the cause of action is ex contractu, rather than ex delicto, and, because of this, survives.

This is apparently the ground upon which a like conclusion was reached in the following cases, although in them **IT WAS SAID THAT A "FIDUCIARY RELATION" EXISTS BETWEEN THE CORPORATION AND ITS DIRECTORS, AND THAT FOR A FAILURE TO PERFORM DUTIES ARISING OUT OF SUCH RELATION** the remedy will survive; it being regarded as an exception to the maxim "Actio personalis moritur cum persona." *Charitable Corporation v. Sutton*, 2 Atk. 400; *Concha v. Murrieta*, 40 Ch. D. 443; *Warren v. Para Shoe Co.*, 166 Mass. 97, 104, 44 N. E. 112."

Bates v. Dresser, et al. (D. C., D. Mass. 229 Fed. 798.

"There was thus sufficient evidence from these directors, themselves that they were

scrutinizing the affairs of the bank; that prior

to the published official report of September 30, 1892, which was followed by the published official report of December 9, 1892, these directors were examining the condition of the bank, that they were considering the losses sustained, the expenses incurred, and the basis of the dividend declared in July. THESE WERE NOT CASUAL STATEMENTS, BUT DELIBERATE ASSERTIONS OF ACIVITY OF SUPERVISION IN RESPONE TO OFFICIAL COMPLAINT. IT WAS PLAINLY PERMISSIBLE, DESPITE THEIR DISCLAIMERS AND DENIALS, to attribute to these directors the knowledge which men of ordinary intelligence would readily have obtained with respect to the financial condition of the bank in the course of the supervision which they professed to be actively exercising. Assuming that they were ignorant of the frauds that had been committed and concealed by falsified entries, there was warrant for the conclusion that they could not have failed to acquire sufficient information to be aware that the representations in the official reports of the latter part of the year 1892 were materially false and calculated to deceive."

Jones National Bank v. Yates, 240 U. S. 562-563; 60 L. Ed. 801-2.

"There is 'in effect' an intentional violation of a statute when one deliberately refuses to examine that which it is his duty to examine. And such was the conduct of plaintiffs in error in this case. They had notice from the Comptroller of the Currency that $194,000 *of the items counted as assets of the bank were doubtful and should be collected or charged*

off. This 'was a direct warning to them,' as the trial court said, 'by the bank examiner and Comptroller, that assets to nearly twice the amount of the capital stock were considered doubtful.' They, notwithstanding, represented the assets to be good. Such disregard of the direction of the officers appointed by the law to examine the affairs of the bank is a violation of the law. Their directions must be observed. Their function and authority cannot be preserved otherwise and be exercised to save the banks from disaster and the public who deal with them and support them from deception."

Thomas v. Taylor, 224 U. S. 82, 56 L. Ed. 678.

"Under what is said to be the universal practice of national banks in making such reports, and under what the undisputed testimony shows to have been the regular practice in this bank, the making and publishing of the reports were the automatic results of the bookkeeping. Whatever the books and daily statements showed the resources to be appeared as resources on the report. If a line of paper was carried at its face among the 'loans and discounts' on the books, it would normally appear at that same amount in every one of the five reports in each year. Both defendants knew this. It follows that it is not important whether each did or did not attest each report (except so far as plaintiff's conclusion to buy might rest on the presence of a particular name at the foot of the report plaintiff saw). All directors who participate in and approve a long-continued carrying on the books, among the loans and discounts, of a line which they

know is worthless, and in amount sufficient materially to affect the standing of the bank, are bound to know that under the practice prevailing in this bank such worthless paper will become an element of the published reports, and that these reports will in so far falsely represent to the public the bank's condition; and so, in a fair sense, such director permits the making of a report which is a violation of the act."

* * *

"Speaking as we are of that duty to unknown persons among the public, the breach of which will support this action, we cannot make a more accurate formulation than to say that the duty to charge off arises when, and so far as, the directors know they are carrying uncollectible paper beyond that reasonable amount and beyond that reasonable time permitted by an honest exercise of their official discretion. ***In other words, it arises when they know that longer carrying will, through the medium of regular reports or otherwise, normally result in substantially misleading the public as to the net value of the bank's assets.***"

Chesbrough v. Woodworth, 195 Fed. 881 and 882.

Jones National Bank v. Yates, 240 U. S. pp. 559 and 560, and at page 562.

Robinson v. Hall, 63 Fed. 226 and 227.

The knowledge of the president was the knowledge of the bank.

Martin v. Webb, 110 U. S. 7;

Manhattan Bank v. Walker, 130 U. S. 267, at p. 280, 32 L. Ed. 963;

Wasson v. Hawkins, 59 Fed. 234.

"IN THE CASE OF BANKERS WHERE GREATER CONFIDENCE IS ASKED AND REPOSED AND WHERE DISHONEST DEALINGS MAY CAUSE WIDE SPREAD DISASTER A MORE RIGID RESPONSIBILITY FOR GOOD FAITH AND HONEST DEALING WILL BE ENFORCED THAN IN THE CASE OF MERCHANTS AND OTHER TRADERS."

St. Louis & San Francisco R. R. v. Johnston, 133 U. S. 566, at p. 576, 33 L. Ed. 686;

Cragie v. Hadley, 99 N. Y. 131.

Mr. F. Lee Major, former assistant bank commissioner of the state of Arkansas, published and put out (The MacMillan Company, 1925) a book, standardized in its application, entitled "The Duties, Responsibilities and Liabilities of Bank Directors," and to save and lighten the labors of this Court, there here follows quotations of the law gathered and compiled, thus by Mr. Major, on these matters as applied to the facts of this record:

Mr. Justice Harlan (*Briggs v. Spaulding,* 141 U. S. 168).

"We (Harlan, Gray, Brewer, Brown) are of the opinion that when the act of Congress declared that the affairs of a national banking association shall be 'managed' by its directors, and that the directors should take an oath to 'diligently and honestly administer' them, it was not intended that they should abdicate their functions and leave its management and the administration of its affairs entirely to executive officers. True, the bank may act by

'duly authorized officers or agents,' in respect to matters of current business and detail that may be properly intrusted to them by the directors. But, certainly, Congress never contemplated that the duty of directors to manage and administer the affairs of a national bank should be in abeyance altogether during any period that particular officers and agents of the association are authorized or permitted by the directors to have full control of its affairs. If the directors of a national bank choose to invest its officers or agents with such control, what the latter do may bind the bank as between it and those dealing with such officers and agents. But the duty remains, as between the directors and those who are interested in the bank, to exercise proper diligence and supervision in respect to what may be done by its officers and agents.

"As to the degree of diligence and the extent of supervision to be exercised by the directors, there can be no room for doubt under the authorities. It is such diligence and supervision as the situation and the nature of the business requires. Their duty is to watch over and guard the interests committed to them. In fidelity to their oaths, and to the obligations they assume, they must do all that reasonably prudent and careful men ought to do for the protection of the interests of others intrusted to their charge." (See pages 99 and 100.)

(*Society v. Underwood*, 9 Bush (Ky.) 609.)

"Bank directors are not mere agents, like cashiers, tellers and clerks. They are trustees for the stockholders; and as to their dealing with the bank, they not only act for it and in

its name, but, in a qualified sense, are the bank itself. It is the duty of the board to exercise a general supervision over the affairs of the bank, and to direct and control the action of its subordinate officers in all important transactions. (p. 100.)

"Directors, by assuming office, agree to give as much of their time and attention to the duties assumed as the proper care of the interests intrusted to them may require. If they are negligent, and losses result from acts committed by those left in control, the directors are responsible to the institution.

"It is the duty of a director to know his bank, and to see that its affairs are honestly and properly managed. He cannot shirk this duty and avoid liability." (page 101.)

Bowerman v. Hamner, supra.

"By accepting the position they (directors) assume capacity to manage the business; impliedly undertake to use diligence and care in perfomance of their duties; must give the enterprise the benefit of their best care and judgment; are bound to manage the bank as carefull as their own business; the fact that they serve without pay does not permit a less degree of activity; must be diligent and careful in their duties, and imprudence and negligence cannot be excused on grounds of ignorance or inexperience." (page 101.)

Mr. Justice Harlan (*Briggs v. Spaulding*, 141 U. S. 174).

"They (directors) ought not, by accepting and holding the position of directors, to give assurance to stockholders and depositors,

whose interests have been committed by their control, that the bank is being safely and honestly managed, without doing what prudent men of business recognize as essential to make such an assurance of value. A banking corporation, publicly avowing that its business was to be wholly administered by executive officers, and that the directors would have nothing in fact to do with its management, would not long retain the confidence of stockholders and depositors, a fact which, of itself, shows that the abdication by directors of their duties and functions not only tends to defeat the object of the creation of such an institution, but puts in peril the interest of the stockholders and depositors." (Major on "The Duties, etc.," page 102.)

"The fact that directors must commit details of business to executives and inferior officers does not absolve them from maintaining reasonable supervision. If such officers waste the bank's assets the directors cannot escape liability on the ground that they did not know of such waste, when it is made to appear that their ignorance was a result of a want of that care which ordinary prudent, diligent men exercise in business." (Major, etc., p. 106.)

(*Scale v. Baker*, 70 Tex. 292)

"If Bank Directors do not manage the affairs and business of the bank according to the directions of the charter and in good faith, they will be liable to make good all losses which their misconduct may inflict upon either stockholders or creditors or both." (Major, etc., p. 106.)

(*Chesborough v. Woodward*, 195 Fed. R. 881.)

"All Directors who participate in and approve a long continued carrying on the books of a bank among the loans and discounts of a line which they know is worthless and in amount sufficient materially to affect the standing of the bank, are bound to know that under the practice prevailing in such bank, such worthless paper will become an element of its published reports, and these reports will in so far falsely represent to the public the bank's condition; and so in a fair sense such Director permits the making of a report which is false; hence his primary duty is to charge off assets which have become worthless." (page 107.)

(*Chesborough v. Woodward*, 195 Fed. R. 881)

"The duty to charge off worthless assets rests on the Board of Directors as an entity. But when this duty is wholly unperformed by the Board, an individual Director, who was engaged jointly in the performance of his functions, may nevertheless be individually liable because of his participation in the failure to charge off such worthless assets, whether or not such assets have entered into and become a part of the published statement of such bank." (page 107.)

(*Chesborough v. Woodruff*, 195 Fed. 876; 116 C. C. A. 465.)

"Let it be conceded that the inattention of a director situated as was Bowerman has been brought about without any evil intention on his part, and that it may therefore work some hardship to hold him liable for the losses due directly to the positive negligence of the president and the loan committee. But there is the other and wider view to be taken, that by which the law must always guard the interests

of the institution and those of the public who were attracted to it . . . the interest of persons who have given their moneys to the custody of the bank, relying upon the belief that the directors, being men of integrity and business capacity, would at least make some effort to see that those in charge of the affairs of the institution would keep within the statutes and the by-laws which control. In the application of this wholesome doctrine one who fails to make any effort to have the bank properly administered acts wrongfully and becomes liable for non-action." (pages 107 and 108.)

"Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision of its officers. They have something more to do than, from time to time, to elect the officers of the bank, and to make declarations of the dividends. That which they ought, by proper diligence, to have known as to the general course of business in the bank, they may be presumed to have known." (page 113.)

"Directors of a bank are bound to use diligence in acquiring knowledge of its business; they cannot be heard, when sued, to say that they were not apprized of facts the existence of which is shown by the books, accounts and correspondence of the bank." (19 Kan. 60) (Major, page 114.)

"This court said by Mr. Justice Harlan, in *Martin v. Webb*, 110 U. S. 15 (28:52) "Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on

around them. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision of its officers. They have something more to do than from time to time to elect the officers of the bank and to make declaration of dividends. That which they ought by proper diligence to have known as to the general course of business in the bank, they may be presumed to have known in any contest between the corporation and those who are justified by the circumstances in dealing with its officers upon the basis of that course of business." (*Auten v. United States National Bank of New York*, 174 U. S. 148).

Auten v. U. S. National Bank, 174 U. S. 148.

The Circuit Court of Appeals for the Fourth Circuit, November 15, 1928, in *Gamble v. Brown*, 29 Fed. (2d) 366, page 371, dealt with a situation such as we have here, as follows:

"It is contended by the defendants, however, that even if the examining committee had functioned, it could not have discovered the embezzlement of the notes by Dean. It is pointed out that K. B. Cecil, a bank examiner and expert accountant, made examinations of the bank in 1914 and failed to discover the shortage until his third visit. The bank examiner made three examinations—on February 19, August 7, and August 22, respectively. The shortage of notes was discovered as the result of the examination of August 7. Certain notes, which should have formed part of the assets of the bank, were represented by

memoranda indicating that they were in the hands of other banks for collection. Between August 7 and August 22, the examiner communicated with these banks and discovered that notes aggregating approximately $17,000 which were supposed to be in their hands, were not so held. Hence he returned on August 22 and closed the bank. A similar check was made by the examiner on February 10, but no shortage was discovered. But it was possible for Dean at that time to have substituted in the note case, without detection, other worthless notes of the Farmers' Loan & Trust Company which he then had on hand. Such a substitution, however, could not have been made later on, when the notes would have matured. *An auditing committee of the bank in the ordinary course would have checked the memoranda of notes in other banks for collection, precisely as did the examiner.* The directors were culpable in this respect, and are liable *to the bank for the losses which their neglect made possible.* We think that the following comment of the special master was justified by the evidence:

"It cannot be urged that the fraud alleged to have been committed by H. H. Dean was so ingeniously devised and concealed *that same would have escaped detection had the directors been more vigilant,* or had proper audits been made of the bank's affairs. The proof shows that the directors were not vigilant, or even careful, and that audits were not made. Had the directors prudently and carefully performed their duties, it is fair to presume either that Dean would not have attempted his dishonest practices, or that they would have been detected. *The directors' indifference opened the way and Dean stepped into it.*"

The Circuit Court of Appeals for the Sixth Circuit, January 15, 1929, in *Robinson v. United States,* 30 Fed. (2d) 25, at page 27 in a case where it was alleged funds of the bank had been misapplied, said:

> "The statute requires, not only that Beauchamp should have misapplied the fund of the bank, but that in so doing he should have intended to injure or defraud the bank. On this record the intent to defraud is as clear as the misapplication. By putting the transaction in a fictitious form, and thus, in effect, representing to the directors and to the bank that he was making this loan upon the security of pledged bales of cotton being then sold, when this was not true, he was deceiving the bank and necessarily defrauding it because of the deceit. When a bank officer misapplies the money of the bank, intends the misapplication, and for that purpose gets the money out of the bank by any kind of a false pretense, the inference of intent to injure or defraud, in the statutory sense, cannot be avoided. *Galbreath v. U. S.* (C. C. A. 6) 257 F. 648, 656."

> "While the cited cases hold that, in a suit for damages against national bank directors, based solely upon a violation of duty imposed by the National Bank Act, it is not enough to show a negligent violation of the act, but that something more, in effect an intentional violation, must be shown to justify a recovery, and that this is the exclusive rule for measuring the responsibility of directors as to such violations, *yet, it is expressly pointed out in the opinion of the court, that the act does not relieve such director from the common law*

duty to be honest and diligent, as is shown by the oath which they are required to take "to diligently and honestly administer the affairs of the association" as well as not "to knowingly violate or willingly permit the violation of any of the provisions of this title," the National Bank Act.

Bowerman v. Hamner, 250 U. S. 510.

The rule thus announced would perhaps be applicable if the bill were limited to the charge of liability based upon the statutory prohibition of excessive loans, for it is reasonably clear that Bowerman did not have actual knowledge of the making of the loans or of anything else connected with the conduct of the bank. ***He deliberately avoided acquiring knowledge of its affairs and wholly abdicated the duty of supervision and control which rested upon him as a director.***

Bowerman v. Hamner, 250 U. S. 510-11.

The National Bank Act imposes various specific duties on directors other than those imposed by the common law, and it is obviously possible that a director may neglect one or more of the former and not any of the latter, or vice versa. For example, in this case we have the gross negligence of the appellant, in failing to discharge his common law duty to diligently administer the affairs of the bank, made the basis for the contention that he did not "knowingly" violate his statutory duty by permitting the excessive loans to be made. While the statute furnishes the exclusive rule for determining whether its provisions have been violated or not, ***this does not prevent the application of the common-law rule for measur-***

ing violations of common-law duties. And there is no sound reason why a bill may not be so framed that, if the evidence fails to establish statutory negligence, but establishes common-law negligence, a decree may be entered accordingly, and thus the necessity for a resort to a second suit avoided.

Bowerman v. Hamner, 250 U. S. 511.

Sometimes the bank, as it did in this case, issues stock for an amount more than par value, in such case allowance must be made for the consequent unearned increase of surplus. (Guthman, Analysis Financial Statements, 1925, at page 362.)

And we find when it did this Spaulding says in his pleading nearly $400,000 went immediately to pay losses, yet the bank was making good statements from September 15, 1922 down to and inclusive of the 28th of March, 1927. *They knew*, they knew; but the stockholders and public did not know until afterwards.

It is laid down as a principle in Robert H. Montgomery's recent treatise, 1925, "On Banks and Their Uses," (Ronald), sec. 23 at page 1205:

> "The proportion that exists between the worth and the debts shows quite clearly the balance between the source and the ownership of the funds being used in the affairs of the business. AS THE PROPORTIONS OF DEBT INCREASE OVER THE FUNDS INVESTED BY THE STOCKHOLDERS, THE INSTITU-

TION BECOMES MORE DEPENDENT FOR WORKING CAPITAL UPON THE DECISIONS OF ITS CREDITORS, AND MORE SUSCEPTIBLE TO THE STRAINS AND PRESSURE OF CRISIS."

The testimony of Mr. Ainsworth, Mr. Dick and Mr. Fraley, coupled with the Examiners' statements of Wilde and Harris disclose precisely that this bank thus became immediately susceptible to this very strain and crisis. Observable and known to everyone as early as 1925; besides cautioned as they were and reprimanded by the Comptroller. THESE DIRECTORS REPLY THEY WOULD ATTEND TO THESE REQUESTS.

The growth of deposits is perhaps the most remarkable feature and is indicative of the aggressive business building policy, which characterized the growth of this bank. (Guthmann, Analysis of Financial Statements, 1925, at page 364.)

Yet building up such condition upon a substruction of inherent weakness was the reason, Stewart gave "FOR HANGING THE CONSEQUENCE UPON SOMEONE ELSE." They were as directors apprehensive; but when told to do they did not.

When cautioned; they remained stationary.

When reprimanded; they promised action, but did not act.

When March came in 1927 with fifteen to eighteen million deposits as Price says all were apprehensive that much, that the directors must do as they then did or be liable to depositors for want of funds to meet demands to pay. No stockholder was so informed except the inside circle with the expressed hope that some one would work them out, or they could sell out.

The best test of a bank's progress is to trace the change in the book value of its shares of stock from period to period. (Guthman, Analysis of Financial Statements, 1925, at page 363.)

So, naturally, on terms suggested in 1923, Ainsworth would not deal; on terms first suggested in 1927, Ainsworth would not deal—Why? because upon being told the bank's INSIDE CONDITION his banking sense told him the foreshadowed results.

So, naturally, on terms suggested in 1927 to Corbett, Adams, Wyld, et al, and the disclosures by Jones, Stewart, Price of the examiners' reports, and the contents of the note pouch, and all inside facts, there was no deal for the First National Bank.

But, what was then done, Price, Ainsworth says, took bonds to him, equivalent to the cash purchase price by the Pittock trustees and their associate directors of the Wheeler checks held by the bank

and Mark Skinner as agent was allowed to carry a Cashier's Check of the bank as agent for said Pittock Trustees, Morden and Price, in the sum of $922,100 around with him and also receive a note TWENTY SOME DAYS AFTERWARDS for one million dollars by the same bank, aside and beyond what the associated directors signed for to the purchasing banks.

There is no doubt in this case as shown by the evidence, that a burden was put upon the stockholders over and beyond that which was assumed by them by the mere relation of being a stockholder, in the nature of the transaction as it was carried out, and the Circuit Court of Appeals, Ninth Circuit so held in *Chase v. Hall*, January 14, 1929, 30 Fed. (2d) 195, page 197, wherein it was said

> "The appellants contend that they are not liable for the assessment for the reason that the debt in the instant case was not incurred in the ordinary course of business or in the ordinary course of liquidation. We cannot agree that the execution of the note was out of the ordinary course of liquidation. It has been held that when a national bank assumes the debts of an insolvent bank in consideration of a transfer of a portion of its assets and a note for the balance, the note represents the contracts, debts, and engagements of the insolvent bank for which its stockholders are responsible. *Wyman v. Wallace*, 201 U. S. 230, 26 S. Ct. 495, 50 L. Ed. 738; *Hulse v. Argetsinger* (D. C.) 12 F. (2d) 933."

"It is not within the power of the officers of the bank, without express authority, by such means to prolong indefinitely an obligation on the part of the shareholders, which is imposed by the statute only as a means of securing the payment of debts by an insolvent bank when it is no longer able to continue business, and for the purpose of effectually winding up its affairs.

Richmond v. Irons, 121 U. S. 66, 30 L. Ed. 875.

Looking at the record when these suits were brought the relation of complainants to the bank and its directors and between them and each of the complainants the law required an accounting; and the authorities on this branch of the case are submitted as follows:

"The rule is universal that courts of equity have jurisdiction to settle accounts whenever a fiduciary relation exists between the parties and the duty to render an account to one of the parties rests upon the other. *Davis v. Hofer*, 38 Or. 153 (63 Pac. 56); 1 Cyc. 427; *Warren v. Holbrook*, 95 Mich. 185 (54 N. W. 712 35 Am. St. Rep. 554); 1 R. C. L. 222; 1 Ency. Pl. & Pr. 96; *Fowle v. Lawrason*, 30 U. S. (5 Pet.) 503 (8 L. Ed. 204.)

1 Ency. Pl. & Pr. 96, Says:

"It may be said generally that whenever there is a fiduciary relation, such as that of trustee, agent, executor, etc., the right to an accounting in equity is undoubted.'

In *Fowle v. Lawrason,* 30 U. S. (5 Pet.) 503 (8 L. Ed. 204), Chief Justice Marshall says, inter alia:

> "In all cases in which an action of account would be proper remedy at law, and in all cases where a trustee is a party, the jurisdiction of a court of equity is undoubted. It is the appropriate tribunal."

In *Davis v. Hofer,* 38 Or. 153 (63 Pac. 56), the court says:

> "The rule is of universal application that a court of equity has jurisdiction to settle an account wherever a fiduciary relation exists between the parties upon whom the duty of keeping accounts rests."

In *Warren v. Holbrook,* 95 Mich. 185 (54 N. W. 712, 35 Am. St. Rep. 554), the syllabus in part is:

> "Where defendant, a bartender, is required to keep an accurate account of all money received, and pay it over to plaintiff, his employer, he occupies a fiduciary relation; and when he has been guilty of a breach of trust, in appropriating funds to his own use, the plaintiff may proceed in equity for an accounting."

1 Cyc. 427, 428, says:

> "Courts of equity have jurisdiction over all trusts for the purpose of compelling an accounting, and the existence of any confidential or fiduciary relation is sufficient to invoke such jurisdiction, whenever the duty arising out of such relation rests upon one of the

parties to render an account to the other. This embraces not only the supervisory power of such courts over trust estates generally, but over acts amounting to breach of trust and fraudulent conduct on the part of persons occupying relations of confidence. In such cases, it is not necessary that the accounts should be mutual, or that the bill should be framed for discovery. And it is no objection that an action at law sounding in damages may be brought for the breach; the legal and equitable remedies are concurrent, and the complainant has his election."

A person is said to act or to receive money or contract a debt in a fiduciary capacity when the business which he transacts or the money or property which he handles is not his own or for his own benefit, but for the benefit of another person to whom he stands in a relation implying and necessitating great confidence and trust on the one part and a high degree of good faith on the other. The term is not restricted to technical or express trusts, but includes such offices or relations as those of attorney at law, guardian, executor, broker, agent, a director of a corporation, etc. Black's Law Dictionary (2 ed.), 496."

Templeton v. Bockler, (144 Pac. 405) 73 Or. 494, p. 507-8-9.

"Equity will assume jurisdiction where there exists a fiduciary relationship between the parties, as in favor of beneficiaries against trustees, including actions against directors of corporations."

Eaton on Equity, page 518.

(See *Phez v. Salem Fruit Union*, 103 Or. top of p. 536).

It is respectfully submitted, therefore, in conclusion, that where before the same trial court the criminal case was tried resulting in the conviction of the president of this bank and J. E. Wheeler upon evidence relating to this same *"float"* as the major premise of that case, much less in quantum and much weaker in strength than the evidence and details in this civil case, and yet, that in this civil case the same trial court on stronger evidence and greater quantum of proof dismisses the bills of complaint, there was error prejudicial to the complainants as herein pointed out. Moreover, the situation is incongruous and inconsistent with the law. There was brought home to the president whom the law says *"his knowledge is the knowledge of the bank"* all of these matters; and he called attention as he swears of Skinner, Price and his other officers and directors thereto. There was every means, to ascertain, and to know, as pointed out in the foregoing facts and law, what the situation actually was; and the conclusion seems inescapable that liability as alleged by the complainants was proved to attach.

Respectfully submitted,

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